

**OVERSIGHT OF THE U.S. SECURITIES
AND EXCHANGE COMMISSION**

HEARING
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COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES
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OVERSIGHT OF THE U.S. SECURITIES AND EXCHANGE COMMISSION

Thursday, June 21, 2018

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:05 a.m., in room 2128, Rayburn House Office Building, Hon. Jeb Hensarling [chairman of the committee] presiding.

Present: Representatives Hensarling, Royce, Lucas, Posey, Luetkemeyer, Huizenga, Stivers, Hultgren, Pittenger, Wagner, Barr, Rothfus, Tipton, Williams, Poliquin, Love, Hill, Emmer, Zeldin, Trott, Loudermilk, Mooney, MacArthur, Davidson, Budd, Kustoff, Tenney, Hollingsworth, Waters, Maloney, Velazquez, Sherman, Meeks, Scott, Green, Cleaver, Ellison, Perlmutter, Himes, Foster, Delaney, Sinema, Beatty, Vargas, Gottheimer, Crist, and Kihuen.

Chairman HENSARLING. The committee will come to order. Members are asked to take their seats. Without objection, the Chair is authorized to declare a recess of the committee at any time. All members will have 5 legislative days within which to submit extraneous materials to the Chair for inclusion in the record.

The hearing is entitled, "Oversight of the U.S. Securities and Exchange Commission." I now recognize myself for 3-1/2 minutes to give an opening statement.

I think we all know that the SEC (U.S. Securities and Exchange Commission) has a well-established three-part mission to include investor protection, the maintenance of fair, orderly, and efficient markets, and the promotion of capital formation. Unfortunately, in the recent past, this latter aspect of the mission has received short shrift. That is why I am very grateful to Chairman Clayton for his leadership in devoting more time and attention to the capital formation mission.

Although our economy is clearly red hot today, there are some worrisome signs that we must confront. Number one, as recently as 2016, entrepreneurship, the provision of startups, reached a 40-year low. We know that IPOs (initial public offering) have been on a slide downward. Although we have seen a gradual uptick, they are half of what they were 20 years ago.

Although we passed a bipartisan banking bill, it is largely a community bank, credit union, and regional banking bill, when 80 percent of our business debt comes from investors in our capital markets, not from lending officers in our banks.

Small business represents 99 percent of all business enterprises and half of our U.S. jobs. Surely they are the job engine of America. When companies do go public, unfortunately, many are withering on the vine.

We have a number of challenges. If these businesses cannot find adequate capital, it begs the question, where will the Amazons, the Googles, and the Apples of tomorrow come from? How can we sustain long-term 3 percent GDP (Gross Domestic Product) growth without ensuring that we have plenty of these startups in the pipeline?

It also begs the question, how will we successfully compete with China, particularly “Made in China 2025,” unless we infuse more reforms into our capital markets because we know China is committed to dominating several different fields in high tech, including high tech, biotech, and artificial intelligence. We know they have a very healthy IPO market and currently produce about roughly a third of the world’s IPOs, IPOs that I think we would much prefer to have in America.

Another question that we have to ask ourselves and ask the SEC, how can Main Street investors have more opportunities to invest in their future? How can they invest in great companies, when we look at our IPO market and see that so many of our public companies are now older, they are bigger, they are fewer?

When they go to the public markets, this is often at a billion dollar valuation when so much of the explosive growth took place as a private company that they were not allowed to invest in. Why was it only the wealthy that managed to invest on these companies on the way up and not our teachers, our barbers, our farmers, and our first responders? We too must act.

We have an opportunity, since we know the Senate will be voting on a package of capital formation bills. Historically, this is something that has been done on a bipartisan basis in this committee. I note again when President Obama signed the first Jobs 1.0 Act into law, he said it was an important step on the journey to remove barriers of capital formation for entrepreneurs. That job must continue, both at the SEC and Congress. I look forward to hearing from our witness on the capital formation agenda of the SEC.

I now turn to the Ranking Member for an opening statement for 3 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman. Welcome back, Chairman Clayton.

Mr. Chairman, given recent developments regarding the Volcker rule, I would like to offer a reminder that Congress put the Volcker rule into effect in order to stop banks from essentially gambling with taxpayer dollars. But earlier this year, the Office of the Comptroller of Currency, the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Commodity Futures Trading Commission (CFTC), and the Securities and Exchange Commission issued a proposal that appears to give banks a pass and allow them to continue what Congress clearly wanted to stop.

Now the SEC’s analysis of the proposed rules said, and I quote, “We recognize that the proposed amendment would increase moral hazard risk related to proprietary trading by allowing dealers to

take positions that are economically equivalent to positions they could have taken in the absence of the 2013 final rule,” end quote.

I am wondering why the SEC would be supporting changes to the Volcker rule that will increase moral hazard risk. I am also concerned about the SEC’s regulation-based interest. In Dodd-Frank, Congress specifically gave the SEC the authority to impose a harmonized fiduciary standard for both brokers and investment advisers. But the SEC’s proposal does not do that. I am going to urge Chairman Clayton to ensure that the SEC’s final rules protect investors and retirement savers from unscrupulous actors.

Mr. Chairman, it has been reported that you have a plan to advance a package of capital markets bills to the House floor. You and I have not talked about this, I have not been consulted on what might be included in such a package. But based on some of the bills the committee has marked up to date, I remain concerned that this package may contain bills that could weaken investor protections, given that any such legislation can make the SEC’s job that much harder.

I am looking forward to Chairman Clayton’s ability to express his concerns to this committee about any measures that he views as potentially harmful to investors, and I look forward to hearing from him throughout this process. I thank you, and I yield back the balance of my time.

Chairman HENSARLING. The gentlelady yields back. The Chair now recognizes the gentleman from Michigan, Mr. Huizenga, the Chairman of our Capital Markets Subcommittee.

Mr. HUIZENGA. Thank you, Mr. Chairman. While, Chairman Clayton, finally our economy is starting to fire on all cylinders, and while tax reform is strengthening our economy, increasing paychecks, it is also starting to deliver real results for hard-working middle-income families, not only in west Michigan, but across the country.

I had an opportunity to meet with a number of NFIB members from Michigan yesterday, and they echoed that sentiment. But moving forward, it is my goal to build on the success of tax reform by continuing to promote policies that empower taxpayers, strengthen our economy, and provide more opportunity for American taxpayers to succeed.

Signed into law the Economic Growth Regulatory Relief and Consumer Protection Act has begun to provide much needed relief to consumers and small businesses on Main Street, but that is just the beginning of unleashing American innovation, jobs, and capital, while supporting economic growth. We can all acknowledge that the United States has the strongest, deepest, most liquid markets in the world, but it is becoming more apparent that our capital markets are becoming less and less attractive, as well, to growing businesses due to the one-size-fits-all securities regulations currently in place.

For public companies, some of which are just a couple hundred million dollars, up to a number of massive companies knocking on the door of \$1 trillion in value. Our capital markets are the envy of the world, but we have to keep it that way. We must jumpstart our capital markets to truly unleash American innovation and eco-

conomic growth and provide greater investment opportunities for Mr. and Mrs. 401(k).

Chairman Clayton, as we can work together, we can further our economy by building on the successes of the Bipartisan Jobs Act. Let's work together to reverse the negative decline in public companies by modernizing our Nation's securities regulatory structure to ensure the free flow of capital, job creation, and economic growth. I appreciate that.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentlelady from New York, Mrs. Maloney, Ranking Member of our Capital Markets Subcommittee.

Mrs. MALONEY. Thank you so much, Mr. Chairman. Welcome, Chairman Clayton.

The SEC has been very active since you were here last October. In April, the Commission proposed a best interest rule for brokers who were giving recommendations to retail investors. We have known for a long time that retail investors do not distinguish between advice they get from investment advisors, who are already subject to the fiduciary rule, and sales recommendations they get from brokers. A best interest rule for brokers is long overdue.

I have to say, I was somewhat disappointed that the SEC did not propose a uniform best interest standard for both investment advisors and brokers who were providing recommendations to retail investors. A uniform standard is exactly what the SEC staff recommended after conducting a lengthy study of this issue in 2011. I am concerned that the SEC's proposed best rule is not as strong as it should have been and is not as strong as the Department of Labor's fiduciary duty rule, so I look forward to hearing from Chairman Clayton on this.

The SEC has also been quite active on cryptocurrencies and limited initial coin offerings. I think the SEC is right to be active in this space because there is a great number of retail investors who are getting hurt in cryptocurrencies. As Chairman Clayton has acknowledged, a lot of the digital tokens that have been issued in ICOs are in reality unregistered securities.

I also look forward to hearing what the SEC is seeking to clarify the loan rule. My time is up. I look forward to your testimony. I yield back. Thank you.

Chairman HENSARLING. The gentlelady yields back.

Today we welcome back to the Committee, for his second appearance before us, the Honorable Jay Clayton, Chairman of the U.S. Securities and Exchange Commission. He received a more thorough introduction in his first appearance, so in the interest of time, we won't say it again.

Chairman Clayton, you are recognized for 5 minutes to give an oral presentation of your testimony. Again, welcome.

STATEMENT OF THE HON. JAY CLAYTON

Mr. CLAYTON. Chairman Hensarling, Ranking Member Waters, members of the Committee, thank you for the opportunity to testify before you today about the work of the SEC. I will attempt to be brief in my opening remarks and refer you to my written testimony, which details our work over the past year.

On behalf of my fellow Commissioners and the 4,500 women and men at the SEC, I would like to thank this Committee for its support. Congress's recent Fiscal Year 2018 funding for the agency is enabling the SEC to make significant investments in furtherance of our efforts to modernize our information technology infrastructure, including improving our cybersecurity risk profile.

Further, Congressional funding, including our current pending Fiscal Year 2019 requests, will allow us to hire experienced staff to improve our expertise relating to our markets, cybersecurity, capital formation, and protecting Main Street investors. We recognize the vote of confidence that Congress has shown in the SEC, and I am committed to ensuring that the agency is a prudent steward of our appropriations, and I know the SEC staff is committed to our mission.

With regard to agency operations, I believe that the agency is running effectively. This is in large part due to the efforts of our senior leadership in our divisions and offices, including our 11 regional offices and their respective teams.

We have many good teams at the SEC. My written testimony outlines many of our accomplishments over the past year, particularly as they relate to the long-term interests of our Main Street investors, including improving our standards of conduct for investment professionals, the integrity of our markets, and overall investor protection.

Additionally, I am pleased that the Commission will meet next Thursday to adopt final amendments to the smaller reporting company definition, which will expand the number of public issuers eligible to provide scaled disclosure.

I also want to bring to your attention the discussion of cybersecurity in my written testimony, including a discussion of our 2016 EDGAR intrusion. The testimony discusses the ongoing internal review of this matter that is being conducted by our Office of the General Counsel (OGC), including the remedial steps we are taking.

Finally, I want to leave you with this. The women and men of the SEC are working hard each and every day, motivated by the fact that tens of millions of Americans are invested in our securities markets for the long term. The accomplishments detailed in my written testimony are because of the individual and collective efforts of these members of our SEC team.

In closing, I would like to again thank the Committee for its continued support of the SEC, its mission, and its people. I look forward to answering any questions you may have.

[The prepared statement of Mr. Clayton can be found on page 50 of the appendix.]

Chairman HENSARLING. The Chair now yields to himself for questioning.

Chairman Clayton, you heard my opening statement. Again, as you well know, there has been a 20-year decline in IPOs. We have roughly half the companies going public than we did 20 years ago. How big of a problem is this? What investment opportunities are Main Street investors losing out on?

Mr. CLAYTON. I think you broke that into two perspectives, both of which are important. The first is, from a capital formation per-

spective, are we impeding capital formation by not having as attractive a market for companies? I think the answer to that is yes. Are there alternatives in the private markets? Yes. But our public capital markets have been an incredible engine for capital formation in America, incredible competitive advantage. We want to keep that.

The second part of your question, does it trouble me that the suite of opportunities that is available to ordinary investors is shrinking on a relative basis because our public capital markets are shrinking on a relative basis? Yes, it troubles me. I do believe that the quality of opportunities that you see in the public capital market space are not as good as the quality opportunities that are available to people with a great deal of capital in the private market space.

Chairman HENSARLING. In your opening statement, you mention that you have noticed an open meeting for Thursday, June 28th to include a number of items on smaller company reporting. Will there be any discussion of 404(b) of Sarbanes-Oxley at that time?

Mr. CLAYTON. Yes, there will be. I expect there will be. The smaller reporting company thresholds are something we are going to be examining, providing more public companies with the opportunity to use scaled disclosure. There are thresholds for when 404(b) is applicable, when companies have to comply with it.

I believe those thresholds should be examined, and I expect a discussion of that at our meeting.

Chairman HENSARLING. I must admit when I meet with a lot of entrepreneurs, venture capital startups, what I typically—and I ask the question. I just recently came back from a trip from Silicon Valley and one of the things I heard when I asked have you considered going public and one pithy answer was it costs too much and it is too big of a hassle.

Of all the cost factors from particularly early growth stage companies is 404(b) of Sarbanes-Oxley. Looking at that on-ramp is something I would commend that you do.

Speaking of commendations, the Treasury Department has 15 different policy recommendations in the capital formation space that the Commission has yet to act on. Again, I applaud you for what you are doing. I wish it might be at a little quicker pace.

I know this Committee has voted on a number of provisions, as has the full House, some of which the SEC could do on its own authority, including providing greater clarity for angel investors in updating the definition of accredited investor.

How important is it that we do that? What is the Commission contemplating at the moment?

Mr. CLAYTON. In the registered space, in the public capital market space, I believe in the process that the Jobs Act—I think, as you referred to it, JOBS Act 1.0—started, which is one-size-fits-all, doesn't make sense for our public companies. We have some at the top of the spectrum, which are incredibly sized companies—200 times, 300 times the size of some of our small- and medium-sized public companies. We are looking at that path provided by the JOBS Act in order to provide scaled disclosure, scaled requirements.

Let me go back to your conversation with Silicon Valley. At what point is a company big enough where going public makes sense? Right now, I think that point is too high on average.

Chairman HENSARLING. Increasingly, it is a billion dollars, isn't it?

Mr. CLAYTON. If you have to get to a billion dollars for it to make sense to access our public capital markets, that is probably too high. In the private space, and particularly what you are focused on is the private offering space that would be available to accredited investors, is looking at the accredited investor definition. I believe it needs to be modernized.

Chairman HENSARLING. My time has expired. I now recognize the Ranking Member for 5 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman. I have a question that I would like to propose. But before I do that, since you mentioned Silicon Valley, I too, was there recently. I was appalled at the lack of diversity.

I know that there are a number of organizations, civil rights organizations that have been working very hard to increase participation of minorities and women in the Silicon Valley businesses. They have not done very well, and of course I would be anxious to be of assistance to them in making sure that we could reduce the costs and reduce the hassle of becoming IPOs.

But we certainly must take into consideration whether or not these companies are developing, understanding that some of us are going to be focused on diversity in those companies.

Having said that, let me go to my question on fiduciary. As we have discussed before, I am concerned that the SEC's proposed Regulation Best Interest does not apply a fiduciary standard to brokers that effectively function as investment advisers by providing retail investors with personalized investment recommendations.

The best way to protect investors and reduce confusion is to treat all advisers, regardless of their titles, the same under a fiduciary standard that requires them to put their clients' interests first. Yet the proposal would only prohibit brokers from calling themselves adviser and fails to address the numerous other titles that may be used, like financial planner or wealth manager.

Don't you agree that it would be far simpler and clearer for investors to subject any broker that holds himself out as providing investment advice or who engages in advisory services to the Advisers Act fiduciary duty and require them to put their clients' interests first?

Mr. CLAYTON. Thank you for raising the question of our proposal to bring clarity to the broker-dealer space and the investment adviser space.

If you will indulge me, I will explain what we are doing. There are two relationship models for retail investor advice in America. There is an investment adviser model and a broker-dealer model. The investment adviser model is a portfolio-based, holistic model where you come to me—I am your investment adviser—and I say tell me what your goals are: Education, retirement, what your risk tolerance is. I am going to help you go over your whole portfolio, monitor it, plan it, and I am going to charge you a fee for doing

that. The fees vary, the types of fees vary, but I am going to charge you a fee. It may be a—we can go into that in more detail.

A broker-dealer model is, you come to me for a recommendation in a specific area on an episodic basis. You say, “Jay, I would like to get some exposure to telecom stocks and maybe some international stocks.” I make you a recommendation. That is the relationship there.

What we are doing in each case, I can’t put my interests ahead of yours. We are bringing to the broker-dealer space that requirement. We are also bringing to the broker-dealer space care obligations, that in getting to the stocks that I will recommend to you, I have to go through a series of steps that ensure that those are right for you in your circumstances.

That is what we are doing in the broker space. But more importantly, the conversation that I just had with you through our Form CRS, our client relationship summary, the customer needs to understand what I am doing in wearing either hat, how I am getting paid, and what my other incentives are. Most importantly, we are going to bring clarity to that space.

You raised a very good point. Does the customer know how I am getting paid and what my motivations are and how I am mitigating the conflicts that creates? There is no conflict-free relationship. There are conflicts in an investment adviser relationship and there are conflicts in a broker-dealer relationship. Disclosing them, mitigating them, making sure that everybody understands what the motivations are, that is what we are going to do in this space. Or I should say that is what I want to do in this space.

Ms. WATERS. I appreciate that. I would like to continue my conversation, my discussions with you on best interest, the client, the customer’s best interest always being put first. I think we need to continue that conversation.

Mr. CLAYTON. I am very happy to. But I want the American people to understand that, in the investment adviser space, the investment adviser fiduciary duty, the way that is applied is you, as the adviser, can’t put your interests ahead of the customer.

That is what we are going to do in the broker-dealer space. You as the broker-dealer can’t put your interests ahead of the customer.

So, and I look forward—we have a long comment period. I want to keep talking.

Ms. WATERS. All right. Thank you.

Chairman HENSARLING. The time of the gentlelady has expired. The Chair now recognizes the gentleman from Michigan, Mr. Huizenga, Chairman of our Capital Markets Subcommittee.

Mr. HUIZENGA. Thank you, Mr. Chairman, and welcome again, Chairman Clayton. We were starting to talk about this—or at least I was in my opening statement about how the SEC needs to take a path to make complex, obscure, outdated rules more relevant for today’s investors and for our capital markets.

I can’t emphasize enough how strongly we need to do this. Many would argue we have a digital, fast-paced capital markets but we are dealing with analog and paper-based regulations, and we need to catch up.

One of those—and I do want to say thank you for—to take a quick moment—is your recent proposed rule on what is commonly

referred to as the loan rule, which was issued May 2nd. This is the type of thing I think will be helpful for us to do that. It will help clarify what for a long time has been a source of ambiguity and uncertainty in capital markets. Thank you for that.

I do want to touch on Kokesh and disgorgement. Last month, SEC's Division of Enforcement co-directors testified in front of the Capital Markets Subcommittee that the SEC has been unable to recover \$800 million in disgorgement since the Supreme Court's Kokesh decision.

In your testimony, you stated, quote, "allowing clever fraudsters to keep their ill-gotten gains at the expense of our Main Street investments, particularly those with fewer savings and more to lose, is inconsistent with basic fairness and undermines the confidence that our capital markets are fair, efficient, and provide Americans with opportunities for a better future," close quote.

Since the Kokesh decision, many have called for extending the statute of limitations assigned to disgorgement, while others have said that giving the SEC the authority to pursue restitution would be counter to the SEC's core mission. I would like to hear from you what you believe Congress should be considering as we are looking at addressing the Kokesh issue.

Mr. CLAYTON. Thank you. I think you described it very well. The Supreme Court in Kokesh determined that disgorgement was a penalty. Therefore, the 5-year statute of limitations that applies to penalties applies to disgorgement remedies.

I believe in statutes of limitations. I think they serve a very important role. What does bother me about that decision from a practical point of view is the most well-concealed frauds may fall outside of that limitations period. I think the SEC should be in the business of getting money back for investors who are subject to fraud, a Ponzi scheme, whatnot. A possible way to do that is to give us restitution authority in those circumstances.

Let me be very direct: I think we should have the authority to get people back their money in those cases. I do think we should bring cases quickly. Statute of limitations drive you to bring cases quickly. But in these very well-concealed situations, we should be able to get people their money back.

Mr. HUIZENG. I look forward to working with you on that because I know I want to ensure that the SEC has the necessary tools to protect those shareholders and investors.

Let's talk briefly about capital markets modernization. As I mentioned in my opening statement, we do have the strongest, deepest, most liquid markets and the envy of the world, but that has been slipping. We know that.

Today's equity markets have been shaped by the 1975 amendments to the Securities and Exchange Act, which goes back to the 1930's. But obviously markets have dramatically changed over the last 40 years. Do you believe that the one-size-fits-all approach to securities regulation is a competitive disadvantage to the United States as compared to our global competitors?

Mr. CLAYTON. We have benefited greatly from our capital markets. We have 4.4 percent of the world's population. We have over 50 percent of the world's largest public companies. It is pretty

amazing. That is largely because of our ability to create capital formation in our public capital markets.

When I meet my regulatory brethren from around the world, they would like to replicate what we have. That is their goal. Now, capital formation around the world is good for all of us, but in the U.S we want to keep this going.

Mr. HUIZENG. Yes. We know that there are some things that are working well. What areas do you think we can improve?

Mr. CLAYTON. I do think we can improve the requirements, the public company requirements, particularly of our smaller and medium-sized companies, to have access to capital. The rules that we have today are the product of history, just as you said.

They are not the—if we sat down this afternoon, all of us, and tried to write rules, they would be different from the rules on the books because life has changed a great deal. Our Division of Corporation Finance has that perspective, and they are looking at recommending changes. We will have a release coming that cleans up a lot, but we need to continually do this.

Mr. HUIZENG. I look forward to working with you. Thanks, Mr. Chairman.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentlelady from New York, Mrs. Maloney, Ranking Member of our Capital Markets Subcommittee.

Mrs. MALONEY. Thank you.

Chairman Clayton, the last time you were here, I asked you whether the SEC's pilot program on access fees charged by exchanges was going to include a zero rebate bucket. You did mention that you were going to include a zero bucket, and thank you very much for that.

My question is, when do you expect to finalize the access fee program, this year, this summer, this fall, this winter? When?

Mr. CLAYTON. We are going through the Administrative Procedures Act process. We have proposed the rule. It is out for comment. I believe that comment period is coming to an end rather quickly. It is on my near-term agenda. If I had to sit here today, I would say sometime this fall.

Mrs. MALONEY. Thank you.

Last month, Bloomberg reported on a very troubling meeting that one of your colleagues, Commissioner Piwowar had with Citigroup. In the wake of the Parkland shootings, Citi had just announced a new policy on guns in which Citi stated that it will require all the retailers that it does business with to adopt best practices on gun sales, such as limiting gun sales to people who are over 21 and have passed a background check and not selling so-called bump stocks.

I think that Citi's new policy is very responsible, a very responsible decision. They weren't the only bank to do so. Bank of America also announced that it would restrict its business with gun manufacturers that make military-style guns for civilian use.

But Commissioner Piwowar was apparently upset with Citi's new policy on guns when he met with a group of their executives in April. According to a press report in Bloomberg, Commission Piwowar, quote, "castigated the Citi executives for," quote, "straying into social policy," end quote.

The report also stated that he issued a thinly veiled threat to Citi, saying that their new gun policy would cause them to lose votes on SEC rules that Citi supported, even though the SEC has absolutely no role in setting firearms policy in the United States.

My question is, do you think it was appropriate for Commissioner Piwowar to use his position at the SEC to try to influence a private company's policies on firearms or any private policy that doesn't affect the SEC?

Mr. CLAYTON. I am not going to comment on the subject matter of those press reports. In a separate hearing over on the Senate side, this was raised, and the question of whether there should be an inspector general's inquiry was raised, and I am going to leave it at that.

Mrs. MALONEY. OK. Then let me ask you, since we are not talking about Piwowar now. But would you base your vote on the SEC rulemaking on whether the companies that support the rule do business with gun manufacturers?

Mr. CLAYTON. I will tell you my perspective—

Mrs. MALONEY. That is not part of an IG report.

Mr. CLAYTON. No, no, no and I will tell you what perspective I bring to this job, which is we have our mission. I pursue all of our rulemaking. We are all human beings. I hope I pursue all of our rulemaking and I pursue all of our enforcement cases with the idea of what is in the long-term interests of the people who put money in our market and leave it there. That is the perspective I bring.

Mrs. MALONEY. Social policy would not influence you? It is the markets and your job?

Mr. CLAYTON. Yes.

Mrs. MALONEY. Thank you. The question also I would like clarification on your proposed best interest rule for broker-dealers. The SEC proposed a rule that says, "a broker can't put his own financial interests ahead of the interest of the retail customer," end quote. The proposed rule then goes on to imply that a broker will satisfy this obligation as long as the broker's interests aren't, quote, "the predominant motivating factor behind the recommendations," end quote.

Is this your intent? Do you really mean to equate these two things? In other words, under the proposed rule, as long as a broker's own interest wasn't the predominant motivating factor behind a recommendation, does that mean the broker automatically did not put his own interest ahead of his customers?

Mr. CLAYTON. I think you are taking that language—let me be clear on what we are proposing. The broker cannot put their interests ahead of the customer's. I believe that language is a recognition of the fact that there is no conflict-free advice model. But we are absolutely clear that the broker can't put their financial or other interests ahead of the client's.

Mrs. MALONEY. Thank you.

Chairman HENSARLING. The time of the gentlelady has expired. The Chair now recognizes the gentleman from Missouri, Mr. Luetkemeyer, Chairman of our Financial Institutions Subcommittee.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

Chairman Clayton, thanks for being here today. Last week, I sent a letter to you and other financial regulators outlining my concerns on guidance being treated by examiners as rules creating binding obligation on financial firms. This practice is fairly prolific in the banking space, but I am not sure your agency is immune from the trend. Essentially, examiners are treating guidance as rule without subjecting anything to the process outlined in the Congressional review process.

Are you willing to communicate to your staff, and in the words of the Federal Reserve Chairman Jay Powell and Vice Chairman Randy Quarles, “that rules are rules and guidance are guidance?”

Mr. CLAYTON. I think that articulates my view of rules and guidance pretty well.

Mr. LUETKEMEYER. I know that in my discussion with Vice Chairman Quarles about this, about the letter he was receiving—I assume you received yours—he wants to be the individual who tries to bring all regulatory agencies together to have a common way of going about issuing guidance, even to the point of having a disclaimer in the guidance that says this is guidance, this is not a rule, and therefore punitive action will not be taken if you do not adhere to this guidance, because it is a suggestion, it is not a rule.

As we have seen with the past Administration, especially with the CFPB, whenever they produce guidance, they suddenly believe that they have the authority to enforce that as a rule. It is very concerning to me. I don’t know that your agency does a lot of it, but I am sure there is some. That is my reason for my concern this morning, and I hope that you will be willing to join us in this effort to try and clear up for your examiners to be able to know what are rules and what are guidance and appropriately adhere to those.

Mr. CLAYTON. I very much agree with clarity in that area, and I very much agree with our system, which is to get to rules, you have to go through a process, and guidance is guidance.

Mr. LUETKEMEYER. Thank you for that.

Also, I have spent a lot of time working on issues surrounding data security in the last several months here and breach notification. Along those lines, I am concerned about the Government’s hypocrisy in setting standards for cybersecurity readiness and disclosure.

The SEC intrusion that occurred in 2016, which you described in your written testimony, wasn’t publicly disclosed until the fall of 2017, shortly after you got there. The SEC itself holds self-regulatory organizations, SROs, to an immediate standard for disclosure of cybersecurity incidents under regulation SCI. Public companies are held to a materiality standard for disclosure.

My question is, should the SEC and other Federal agencies be held to the same standard which they hold with respect to supervised entities and SROs?

Mr. CLAYTON. The short answer to that question is, based on my experience at the agency and with other agencies, I don’t think it should be the same standard. There are governmental considerations that would go into whether to make a disclosure or not.

Do the same principles apply when we decided to disclose our cyber incident? Was it on my mind that the American people should know and that they should know what we are doing about

it? Absolutely. But I could see other circumstances, maybe not at the SEC, but at other agencies, where national security and other considerations weigh against immediate disclosure.

I don't want to say, certainly for other agencies or make a blanket statement that the exact same standard should apply. But should we be thinking about what I consider our shareholders, the American people, as we disclose what happens? Absolutely. That is the approach that we took when we disclosed the cyber incident.

Mr. LUETKEMEYER. I know that the OGC is doing an internal review of the incident, and they are not done yet, according to your testimony this morning. We don't have some answers there. But, I am very concerned. We have discussed this before. It took a year for this disclosure to happen.

I understand national security interest. I understand that law enforcement may want to try and find a way to track down the guys or gals or entities, whoever they are, who are trying to break in and do nefarious things here.

But at the same time, as you just disclosed, you are the keeper of the private data of our citizens. The last time we talked about this, my question to you was, did you feel that the markets were manipulated by this event of people getting into your data? Your response was, we are not sure, I don't think so.

Quite frankly Chairman, that answer is not good enough. We have to improve on that. I am hopeful that the report will give you the guidance it takes to make sure this doesn't happen again and, if it does, that there could be a more timely disclosure of this incident so that the people can take their own actions to protect themselves or that businesses can take their own actions to protect themselves, if the data is disclosed.

I yield back. Thank you.

Mr. CLAYTON. I agree.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentlelady from New York, Ms. Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman. Mr. Clayton, welcome.

Mr. CLAYTON. Thank you.

Ms. VELAZQUEZ. Puerto Rico has been hit by two hurricanes, a financial crisis that entailed many actors, including government mismanagement, bondholders, hedge funds, vultures, and then Hurricane Maria. I offered legislation that was included in S. 2155, and that legislation is known as the U.S. Territories Investor Protection Act closes a huge loophole that allow UBS and other financial firms operating in Puerto Rico and in any other U.S. territory to rip off millions from ordinary investors.

My question to you is, when can we expect the SEC to begin implementing this badly needed provision?

Mr. CLAYTON. Thank you. This is the provision that removes the exemption from the 1940 Act for funds organized?

Ms. VELAZQUEZ. Correct, yes.

Mr. CLAYTON. I thank you for that legislation. We are going to move forward with that. I think you characterized it correctly. It does close what could be characterized as a loophole, and it should be done.

Ms. VELAZQUEZ. OK. I am very excited to hear that. Mr. Clayton, I am also concerned that a position of advocate for small business capital formation has not been filled. Do you see any value in that position?

Mr. CLAYTON. I am disappointed that we have not yet filled that position. We have employed a search firm to try and help us find the right person for that. More importantly to your question, why am I disappointed? I think that voice should be a permanent voice in the work we do at the SEC.

Ms. VELAZQUEZ. When do you expect to fill that position?

Mr. CLAYTON. I would like to fill it tomorrow. We have some candidates that we are vetting. This is a Commission decision, so I can't speak for my fellow Commissioners, but I would like to do it as quickly as possible.

Ms. VELAZQUEZ. OK. Let me explain to you why I am so concerned about the fact that that position has not been filled since it was created in 2016. Earlier this year, language of my bill, 4792, the Small Business Access to Capital After a Natural Disaster Act, was enacted into law. The bill requires the SEC advocate for small business capital formation to issue a report to Congress on ways small businesses can access private capital following a hurricane or other natural disaster.

This report cannot be issued until an advocate is hired. I hear that you are committed and that you will not come here 6 months later and I will ask the same question to hear that it has not been filled.

Mr. CLAYTON. I sure hope not.

Ms. VELAZQUEZ. Will you be interviewing candidates with experience on capital formation issues after a natural disaster?

Mr. CLAYTON. We are interviewing candidates. In the context of interviewing candidates, the interviews that I have had, I have not asked that question, but I will now.

Ms. VELAZQUEZ. In terms of the specific language that was included into the bill, it requires someone to be able to issue a report related to capital formation, access to capital formation after a natural disaster.

Earlier this week, the SEC imposed Bank of America's subsidiary Merrill Lynch with a \$42 million civil penalty for misleading customers about how it handled their orders. While Merrill Lynch entered the scheme known as masking, in May 2013, the SEC order indicates that Merrill Lynch did not inform customers about its past practices, but rather took steps to hide the misconduct.

This follows an SEC announcement earlier this month that Merrill Lynch will pay more than \$15 million to settle charges. Can you tell us how the SEC determined the level of fines and payments against Merrill Lynch in each of these two instances?

Mr. CLAYTON. I don't think it is appropriate for me to comment on the specific circumstances of a case. I can tell you that the way we operate is, our Division of Enforcement and the people tasked with bringing these cases, formulate a recommendation to the Commission, and the fine and the other sanctions are part of that recommendation, and that is what we vote on.

Chairman HENSARLING. The time of the gentlelady has expired. The Chair now recognizes the gentlelady from Missouri, Mrs. Wagner, Chair of our Oversight and Investigations Subcommittee.

Mrs. WAGNER. Thank you, Chairman Hensarling. Welcome, Chairman Clayton. Breaking news: The Supreme Court just ruled that the SEC did not follow proper procedures prior to your moving into this space and into this job when appointing administrative law judges. In fact, it says that these administrative law judges appointed by the SEC and other Federal agencies are inferior officers, and many of these inferior officers have adversely affected a number of my constituents in Missouri's Second Congressional District, and that they are subject to the appointments clause of the Constitution.

I think this is going to have broad ramifications now for an array of Federal agencies that employ in-house judges, including the SEC. I know this is breaking news, but I look forward to hearing how this will influence your practices at the SEC vis-a-vis the administrative law judges going forward. I just thought I would toss that out there.

I want to start this morning by thanking you and your staff for their work on the proposed best interest standard rule. As many of my colleagues know, I have been an outspoken critic of the Department of Labor's misguided fiduciary rule, and I am happy to see that the SEC is finally taking the lead as Dodd-Frank, frankly, asked them to do some 8 years ago.

In testimony before the Committee last year, you identified key principles that you felt needed to guide the SEC's approach when seeking a new rule that is, in fact, a best interest standard for broker-dealers in these areas for clarity, consistency, and coordination.

Let me start by asking you this: Do you believe the SEC has achieved this goal in their proposed rule?

Mr. CLAYTON. I do. I want to say, we took those concepts and then we added an additional lens. This was a truly collaborative effort around the—

Mrs. WAGNER. With the Department of Labor, I hope, too.

Mr. CLAYTON. With the Department of Labor. I am in contact with Secretary Acosta. Our staffs are in contact with each other. In fact, our inspection staff recently connected with the Department of Labor to show how we would inspect for compliance with this rule. We want to bring a common approach to this space.

The other thing that came out of this drafting process and interactions was, let's align what investors expect from their professional with the law. Because if we are aligning expectations, it is a lot easier to get clarity.

Mrs. WAGNER. Agreed. I have several more questions. You talked about having investor testing. Has that process started? If not, are you still going to follow through with that part of the proposed rule?

Mr. CLAYTON. Our Office of the Investor Advocate is doing investor testing, but that is not the only investor testing we are doing. We have scheduled six town halls around the country to go out and interact with investors, explain the rule to them, ask them what

they think about it. I have participated in the first two; I plan to participate in two of the remaining four.

Mrs. WAGNER. Great.

Mr. CLAYTON. That is actually really valuable.

Mrs. WAGNER. Are you willing to make this feedback that you get from the investor testing public, sir?

Mr. CLAYTON. Investor testing feedback?

Mrs. WAGNER. Yes, are you willing to make this public, your findings through these investor testings? I know you are saying about a public town hall, so I assume that would be public.

Mr. CLAYTON. That is all public. Comments are all public. I don't want to make a blanket statement, but I expect that the results of the investor testing will be publicly available in some form.

Mrs. WAGNER. In testimony before the Senate Appropriations Committee, you said, quote, "I am not going to take forever," referring to completing the rule. I know the comment period ends the first week of August. Are you still on track, Chairman Clayton, to complete the comment period? Or do you think you are going to need to extend it?

Mr. CLAYTON. I think I will see in August. But right now I think a good comment, good lengthy comment period of 90 days. This issue has been around for at least 10 years.

Mrs. WAGNER. Don't I know.

Mr. CLAYTON. It is time for—people have been heard—

Mrs. WAGNER. Has the response from the industry been positive? Because it is the industry that actually represents the low- and middle-income investors and retail savers that we are trying to protect. Has it been positive, the feedback?

Mr. CLAYTON. I think overall, I am very pleased with the feedback.

Mrs. WAGNER. So am I. I have preemption questions, Mr. Chairman, that I want to talk about, but I think I will submit those for the record, and I yield back the balance of my time, and I thank you for your tremendous work in this arena.

Chairman HENSARLING. The time of the gentlelady has expired. The Chair now recognizes the gentleman from California, Mr. Sherman.

Mr. SHERMAN. Mr. Luetkemeyer and I and others have worked to try to have more information sent electronically with paper only being sent when requested. When you were here in October, I asked you about Rule 30e-3 and I want to thank you for moving forward with that rule, which will modernize the default delivery method for mutual fund disclosures from paper to electronic, while protecting a permanent right to paper for those who prefer it. You are going to save investors \$2 billion. You are going to save 2 million trees. Good work.

Mr. CLAYTON. Thanks.

Mr. SHERMAN. My question is, what more can the SEC do in terms of electronic delivery that can benefit investors and trees?

Mr. CLAYTON. So that—30e-3 was a big step. I appreciate all the comments from this Committee and others. I think we landed in a good spot. But it is just a start. As has been discussed in many of the questions today, modernizing our rules, including our communications methods, is front of mind in our Division of Invest-

ment Management, our Division of Corporation Finance, and throughout the SEC. Next Thursday, I expect we will vote on XBRL and the inclusion of XBRL tagging, which, again, is aimed at modernizing our delivery of data to the investment community.

Mr. SHERMAN. Let me move on. The SEC has pretty much left it to the FASB (Financial Accounting Standards Board), but accounting is what determines what happens to stock prices. Financial statements are based on a 100-year-old view as to what every company would disclose in terms of numerical information.

But investors care. For example, if you are investing in retail stores, you want to know same store sales. I hope that the SEC would look toward either you or getting FASB to define the terms that are important to numerical information to investors in particular industries and to make sure that those numbers are audited, because right now Target has one definition of same store sales, Nordstrom has another, and both of them issue unaudited information. But I will ask you to respond to that for the record.

I want to associate myself with the comments about cryptocurrencies—they are securities, as you pointed out to the Senate—and pick up on your current about accredited investor rules. When these rules came out, the definition was a million dollars in assets, \$200,000 in income, and those were staggeringly high numbers in the 1980's.

Now, in effect, those numbers represent one-third of the purchasing power, 10 times as many families fit into the category, which means 10 times as many families don't get the protection. One of my colleagues asked, why can't the average barber or teacher get all those great investments that seem to be reserved for—why can't anybody charge into the minefield? Why do we limit that just to explosive ordnance disposal experts?

Will you revisit the accredited investor definition and index up those numbers? Because either they were wrong when the SEC issued them or they are wrong now.

Mr. CLAYTON. There is a lot to—let me agree with you on the concept of an accredited investor definition, which is, no, we shouldn't just let people charge into the minefield, as you characterize it, without ascertaining to some extent whether they are capable of handling the private investment arena. Completely agree with that. We have chosen the accredited investor definition as that gatekeeping function to the private investor arena—

Mr. SHERMAN. This doesn't mean that they can't make the investment. It just means that they need to get advice, and all those rich people who make these investments are getting advice and putting in effort.

Mr. CLAYTON. Anyway, we can have a longer discussion about this.

Mr. SHERMAN. Yes, because I—

Mr. CLAYTON. It is a very complicated issue.

Mr. SHERMAN. I want to sneak in one more question.

Mr. CLAYTON. OK.

Mr. SHERMAN. We had the meltdown in 2008 because the bond rating agencies gave AAA to Alt A. They gave buy ratings to bad bonds. We put into Dodd-Frank a provision, the Franken-Sherman Amendment, that would eliminate the system where the issuer se-

lects the bond rating agency. We don't let the home team select the umpire, especially if the umpire makes a million dollars a game.

I would hope—the SEC found a loophole in that requirement, issued a report and decided not to do it. That was your predecessor's mistake. I hope you will take a look at this and use the power you have to end the issuer selects rater system.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Kentucky, Mr. Barr, Chairman of our Monetary Policy and Trade Subcommittee.

Mr. BARR. Thank you, Mr. Chairman.

Chairman Clayton, good to see you again. Thanks for being with us. Some publicly traded firms, especially early stage bio firms, and some equity exchanges have expressed concern about the absence of a disclosure requirement for those who bet against a company by taking a large short position in that company's stock.

They point out that there is a regulatory gap between long and short sellers since there are extensive disclosure obligations for investors who bet on a company by buying its stock or investing long. They have argued in favor of a short position disclosure regime, noting that long positions over 5 percent of outstanding shares require public disclosure while equally large short positions have no comparable requirement.

On the other side of this argument, there are those who will point out the critical liquidity provided by short selling. They make the point that short positions are by definition not related to corporate ownership and instead are a strategic trading tool. They don't share the view that stealth short positions are as big of an issue.

Again, they make the point that short positions provide critical liquidity to public markets and that short sellers are responsible for a substantial portion of equity trading volume, and that short sellers, because they provide that heterogeneity of views in equity markets about future share prices, provide efficiency to the markets.

The concern that they express with a disclosure regime would be that the reporting requirements would discourage institutional investors from taking short positions. Those reporting costs would then reduce overall short positions and, therefore, reduce market liquidity. I am just setting up the debate there.

I would be interested—now, of course, there is a provision in Dodd-Frank that counsels the SEC in favor of a disclosure regime for short positions, large short positions. I am wondering if you or the Commission have a view on this issue and how would you approach that issue if asked to do so?

Mr. CLAYTON. I don't have a definitive view on a particular rule as we sit here today or not a rule, but I think you framed it very well. If you don't mind, to try and give you my perspective, I will frame it as I look at it, which is, there are valid points in those arguments. The people who say that being able to go short and doing so as a fundamental view on the company adds liquidity, adds discipline, adds price transparency to the market. Great. I agree.

There are people who say that there are people who use short selling not because of a fundamentally different view of the price

of the company, not for liquidity, but to take advantage of trading opportunities that cause the company's quoted value to depart from what it otherwise might be. To the extent we can get at that type of behavior, if it exists, I don't know to the extent to which it exists, but if it exists, the extent to which it exists without affecting liquidity and the discipline, that is how you should look at that problem in my view.

Mr. BARR. Yes, it is a balancing act for sure, and I appreciate your thoughts on that. In your last appearance before us, Mr. Chairman, you talked about the importance of reducing the reporting requirements for public companies to reduce some of the burdens that are maybe limiting IPOs. You did respond with respect to a question I had about disclosures for mining companies.

I am just wondering—and the response that you sent to us on March 23rd indicated that you planned to finalize rules to modernize and clarify certain disclosure requirements for companies engaged in mining operations. Do you have any update on that?

Mr. CLAYTON. We are working on a proposed rule. It is on our short-term agenda. I will just reiterate this. Our short-term agenda that we publish and are required to publish is what we are trying to finish in this fiscal year.

Mr. BARR. Finally, we recognize that getting the fiduciary rule-making right is more important than rushing the process and getting it wrong, but as you know, many broker-dealers in anticipation of the DOL rule have invested a considerable amount of time and energy and resources in getting ready for that. Just curious about a timetable, because the uncertainty is creating some level of consternation.

Mr. CLAYTON. The comment period ends in August. We will collect the comments, go through the process. I am not going to set a specific date, but we should not take forever.

Mr. BARR. Thank you. I yield back.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Georgia, Mr. Scott.

Mr. SCOTT. Thank you, Mr. Chairman. I appreciate it. Welcome, Mr. Clayton. It is always good to have you.

I have been at the front of the spear on this fiduciary rule since its very conception. You recall that when we put Dodd-Frank together, we required the SEC to come up with a rule that would raise the broker-dealer standard and would harmonize that standard with the obligations that investment advisers have to follow today.

Now, here is the point. When we did that, we put that in Dodd-Frank, but we exclusively said that was the SEC's responsibility, not the Department of Labor. Now, the Department of Labor does have a piece in this, of course, with the retirement accounts, but you see where this is if we don't have the SEC at the leadership, being aggressive, to be able to set these standards the way they are.

As I said, I have been dealing with this. I was the only Democrat to cross over and vote for this bill with Mrs. Wagner. We were able to increase that great bipartisanship when we got it to the floor with two more Democrats. We are growing this bipartisanship, but

there is great concern on both sides of the aisle, but certainly on mine, as to confusion within this.

For example, in terms of establishing the best interests that you have going forward, you have said that to do this we must meet several obligations. First, there is the disclosure obligation. Then we have the care obligation. Then we have the conflict of interest obligation.

My concern and the concern of both the investment community as well as the investor is that these concerns, this complexity makes it difficult for the investment industry to discern what we need, which is a clear path to compliance. You have done a remarkable job in explaining this.

But I want to ask you, do you believe that the Securities and Exchange Commission is the best suited place to come up with a standard that indeed can be harmonized across all investment categories and all types of investment adviser?

Mr. CLAYTON. I firmly believe that.

Mr. SCOTT. All right. Let me ask you this, also, because here is another major concern, and this is where I understand the Labor Department's retirement situation. We are faced with a horrendous retirement boom right now, because we have this baby boomer generation that really produced itself right after World War II that is coming.

I wanted to know if you will commit to this committee today that your intention is to see this proposal through to the final rule-making. Now, that question has been asked to you in a couple of different ways, but you haven't been clear. Are you going to be the man that is going to see this through to the end?

Mr. CLAYTON. No one person can do this, but this is—

Mr. SCOTT. Will you be the captain of the ship?

Mr. CLAYTON. Yes.

Mr. SCOTT. You said you will?

Mr. CLAYTON. Yes.

Mr. SCOTT. All right. Thank you.

Mr. CLAYTON. Thank you.

Mr. SCOTT. Glad you will be the captain of the ship.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Oklahoma, Mr. Lucas, former Chairman of the House Agricultural Committee.

Mr. LUCAS. Thank you, Mr. Chairman. I can't speak to the issue of who is captain of the ship, but in my time on this committee, I have always tried to be very pragmatic and very practical in my perspectives, my questions, and the focus.

If you don't mind, Chairman Clayton, let's visit for a moment about some issues that impact a very large and substantially important job creator in my district. While everyone thinks about me as the ag guy, we have a major oil and gas industry in Oklahoma. As many of my colleagues know, the United States has experienced a rather remarkable growth in energy independence, and that has occurred primarily due to the increase in shale production in places like the Bakken and in the Marcellus formations.

But I would like to focus on how the SEC treats proven, but undeveloped reserves, because it concerns me a bit. Currently domestic producers can report on their annual filings only those reserves

they plan to recover within a 5-year window. This has been the policy since 2008.

At that time, shale accounted for a much smaller percentage of oil and gas production than it does now, and I would suggest to you that this 5-year rule might not reflect the realities of the new American energy landscape. These shale formations are so vast and finite that a proper development plan will often exceed 5 years.

Chairman Clayton, given this change in domestic energy production, have you and your staff given any thoughts to changing the 5-year rule for these reserves?

Mr. CLAYTON. The short answer is yes, we have given thought—and let me make sure that, if you indulge me, make sure we are on the same page. It is in particular, yes, because I am concerned in this space that the way our rules require disclosure is inconsistent with the way investors value these companies. They are looking for additional disclosures, and we should make sure that our rules line up with what investors think is the material information.

Mr. LUCAS. Exactly. Because from my perspective, the 5-year rule may prevent a business from being able to disclose the full extent of its assets to investors.

Mr. CLAYTON. I will actually just add to that, that when that is the case, you have information asymmetries, and that is not what we want.

Mr. LUCAS. I will leave on this particular question with one last thought, and that is 51 percent of all domestic crude oil and 63 percent, almost 64 percent of all domestic natural gas come from shale formations, and I think that is just an amazing statement about the advances in technology and utilization and all those things.

Second, I noticed in your testimony that you expressed a commitment to working on the Commission's Title VII regulations surrounding security based swaps. I very much appreciate this, given my desire to see derivatives markets work for all participants and, quite frankly, the long delay in getting these regulations out the door.

I also very much appreciate your testimony mentioned active engagement with the CFTC. Can you elaborate at all on some of that engagement with your colleagues at the other entity?

Mr. CLAYTON. Yes. We have set up a bilateral process to get through the rules that we need to get through with the hope of ensuring that they are either harmonized or, if we can't harmonize them because of our different mandates and the different types, that they are at least not inconsistent or creating problems for each other. But we are working closely with the CFTC, and I want to say, I really appreciate the leadership of Chairman Giancarlo in that area.

Mr. LUCAS. I think he is a great leader, and you have touched on exactly the point that I was trying to make, whether it was Treasury reports last year calling for more harmonization or just the nature of the markets. I think it is critically important that everyone be able to utilize these tools in their businesses in the most cost-effective fashion possible.

Therefore, Mr. Chairman, in that spirit of brevity and focus, I thank you for my time, and lo and behold, Mr. Chairman, I yield back.

Chairman HENSARLING. The gentleman from Oklahoma yields back. The Chair now recognizes the gentleman from New York, Mr. Meeks.

Mr. MEEKS. Thank you, Mr. Chairman. Welcome, Commissioner Clayton. Now that I know that you are, in fact, the captain of the ship.

Mr. CLAYTON. I knew that was going to get me in trouble. Thanks, Mr. Scott.

Mr. MEEKS. I want to follow up on some questions that I posed to one of your lieutenants, the director of the SEC's Division of Corporation and Finance in April. I asked him about the SEC's intention to either adopt or reject recommendations from the agency's Investor Advisory Committee.

The committee recommended better disclosure rules around dual-class stock structures. The advisory committee also recommended creating a pilot program to monitor shareholder disputes arising out of such structures. These structures are common among Silicon Valley's tech giants, like Facebook.

In fact, you may have seen where there was—I read in an article—an investors revolt against Mark Zuckerberg at the annual shareholders' meeting, because they can create a system where the average investors, including teachers and firefighters and the like, have less power to hold CEOs and board directors accountable. We see when we can't, things can happen.

My question to you is, A, what is your personal opinion on the potential investor harm posed by dual-class stock structures? And, B, what is the status of the investor advisory's recommendations at the SEC?

Mr. CLAYTON. OK. Let me, if you don't mind, I will take those in reverse order. The Investor Advisory Committee recommendation regarding making sure that the disclosure around governance and what dual-class structures mean to governance, in particular to your point, what it means to investors in terms of their ability to participate in governance, I 100 percent agree that that disclosure needs to be clear and accessible.

To the extent it is murky, it should not be. Your rights as a shareholder, whether they are one share, one vote or whether there is a super vote stock that dilutes your voting ownership, you should be able to know that clearly from the disclosure. I believe that.

Now, my personal views on corporate governance, I am not a one-size-fits-all corporate governance person. My experience across our markets and across the globe is that trying to dictate a one-size-fits-all governance model for public companies does not make sense. I do recognize that there are models that are so extreme that they cause problems.

Mr. MEEKS. These dual-class stock structures you are saying in some places they may fit and in some places they may not? Is that what you are saying?

Mr. CLAYTON. I think, yes, to the extent you take a dual-class structure to an extreme—let me give you an example. Somebody has complete voting ownership over a company, but has no eco-

conomic stake in the game. As a person who looks at investments, that kind of outcome troubles me. Does it trouble me to say that a founding group of people who want to take their company public but don't want to be subject to the vagaries of short-termism should have some control over it? That absolutely resonates with me, as well.

Mr. MEEKS. Thank you. That is clear.

Let me also ask you, Commissioner Clayton, and I have asked you this before, about the SEC's intentions to go beyond merely monitoring its board diversity rule and to actually improving the board diversity rule. Investors and the SEC's advisory committee on small and emerging companies have found the current board diversity rule to be unhelpful in determining the race, gender, and ethnicity of board directors.

In April, your director of corporate finance mentioned to me that the board diversity rule is back on the SEC's rulemaking agenda. Is this the case? After monitoring compliance with the board diversity rule for some months, have you come to a conclusion on whether or not the rule should be enhanced so that investors could have more complete information on the composition of their boards?

Mr. CLAYTON. Yes, it is the case. The dialog that Director Hinman and his colleagues have had with companies around this, two of the issues that you raised has, I would say, raised some additional considerations about what companies think is appropriate and what the individual directors think is the appropriate type of disclosure. But I expect that we are going to move forward in some form. I don't want to—I never want to overpromise—but some form with this rule. It is on our rulemaking agenda, and we are going to do something.

Mr. MEEKS. Thank you.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from North Carolina, Mr. Pittenger.

Mr. PITTENGER. Thank you, Mr. Chairman. Chairman Clayton, thanks for being with us today. I sure appreciate your hard work at the SEC over this year, I really commend you, as well, for your regulation in the best interest for broker-dealers, and thanks for seeing that through. I think it will be clearly important to protect investors and preserve their choices in the future.

Chairman Clayton, tell me your impressions of FIMSAC, the Fixed Income Market Structure Advisory Committee, and after 6 months and its first meeting, are you satisfied with where they are headed and what is the focus of their agenda moving forward?

Mr. CLAYTON. Look, it is early days. But if you ask me to give them a grade, I give them an A. This is a group of people who are giving up their time—it is a very diverse group of people in terms of perspectives, participation in the market. We have people who are in the public sector.

I won't go into all of that, but they are looking at how the fixed-income market is evolving, and the fixed-income market is evolving toward electronification. Products are changing, and they are trying to come up with recommendations that make sense to make the market better, including around trading and transparency. We are going to benefit from their work.

Mr. PITTENGER. At the end of the day, what will be the best outcome? What do you think can be achieved as a result of their input?

Mr. CLAYTON. Adding liquidity to the market. People understanding where there may not be the liquidity that they think there is. Making sure that trading is efficient.

Mr. PITTENGER. As it relates to corporate bond transactions, the block trades, do you intend to move forward with FIMSAC's advisory board recommendations?

Mr. CLAYTON. That is a recommendation that has to go to FINRA in the first place, but I am encouraging FINRA to take that recommendation very seriously.

Mr. PITTENGER. On another point, what legislative action do you think would be most helpful to support capital raising by new and small businesses?

Mr. CLAYTON. Most helpful for small businesses?

Mr. PITTENGER. New and small, sure.

Mr. CLAYTON. Here is the conundrum for new and small businesses in terms of raising capital. Raising capital from a single source or several sources is not that costly, relatively. When you try to raise capital as a small business from multiple sources, the transactions costs are high. What we are looking at is ways to bring those transactions costs down without hurting investor protection. That is what we are trying to do.

Mr. PITTENGER. Yes, sir. We certainly see the impediments have been there in the past, and any efforts that can be made there to allow greater capital investment would be—

Mr. CLAYTON. I think modernizing the definition of accredited investor is one of those steps, to be clear.

Mr. PITTENGER. Thank you. Would you also speak to what the SEC is doing to ensure that small businesses remain the backbone of our economy? But what do you foresee in terms of your role to ensure that small businesses have the central role in the backbone?

Mr. CLAYTON. Small businesses are so important to our economy. We talked about capital raising for small businesses and access to capital, and the SEC has a role in that, just as our banking regulators and other regulators do, because they get capital in other ways.

I am hopeful that the way we are approaching the covered funds issue in Volcker will free up some capital for small businesses, particularly in areas of the country where there is not a large venture capital community. That is one of the things I am hopeful for.

Another thing for small businesses is to continue that path from being a small business—some small businesses just stay small businesses and that is a very important part of our economy. But keeping that path from small businesses to become a bit larger, a bit larger, and having access to capital throughout the lifecycle, that is an important part of our job.

Mr. PITTENGER. You have seen in the past decade there has been a real limit and restriction in terms of the emergence of small business. Of course that in itself to me has been the biggest concern that I have had on the ongoing growth of our economy, because without the infusion of the needed capital, the access to credit, and the ability for small businesses to emerge, our economy floundered.

That was my gravest concern, is what would happen in the future long-term if this wasn't addressed.

Mr. CLAYTON. Can I add to that?

Mr. PITTENGER. Yes, sir.

Mr. CLAYTON. Just as a citizen, the connection between growing businesses and small businesses should not be lost. Lots of businesses that move from small, medium size to large drive the creation of small businesses.

Mr. PITTENGER. Yes, sir.

Mr. CLAYTON. We need to continue both of those things.

Mr. PITTENGER. Thank you. My time has expired.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Colorado, Mr. Perlmutter.

Mr. PERLMUTTER. Mr. Chairman, thanks for being here. We look forward to your visit to Colorado in a couple weeks.

I have three areas I want to talk to you about, marijuana, cybersecurity, and cryptocurrencies. I will start with marijuana. We have the Controlled Substances Act, which is at odds with now 47 States and the District of Columbia that have some level of marijuana use, whether it is cannabis oil for seizures, medical marijuana, or fully legalized commercial sale.

Canada, a couple days ago just legalized marijuana, and we were talking earlier about IPOs and where have all the IPOs gone. Many of them have gone, for a variety of reasons, to the Canadian exchanges. We know American marijuana businesses have gone public by holding IPOs on the Canadian securities exchange, the Toronto exchange, and the TSX exchange.

I am curious, sir, whether you have seen any effort on our exchanges, either for marijuana businesses, direct marijuana businesses, or the ancillary businesses to marijuana, whether you have had any issues from an enforcement point of view or from a regulatory point of view in dealing with businesses here in the United States that publicly trade and are related to the marijuana business?

Mr. CLAYTON. Nothing specific that comes to mind. I think what you said, are we seeing impediments?

Mr. PERLMUTTER. Yes. Have you had any cases where you as a regulator or an enforcer of the law have had to say you can't take this company public, it violates the Controlled Substances Act? That would be one question. Another question is, if it is a company that the primary part of their business is to supply electric lighting or nursery things to marijuana grow operations, is that something you would require as part of a disclosure?

Mr. CLAYTON. Let's go back to the touchstone, which is materiality. If there is something material to investors in making the investment decision in connection with, for example, an IPO—and to use the industry you are talking about—is regulatory uncertainty or regulatory—likelihood of additional regulatory developments, something that should be disclosed to investors. My position—I have to be careful about any specific type of thing—but, yes, that is the type of disclosure you would expect to see in an industry subject to regulation and particularly an industry that is in flux.

Mr. PERLMUTTER. Has it come to your attention whether there has been an impediment, to use your word, or some limitation to companies that may want to go public related to a marijuana business or in supplying the marijuana businesses?

Mr. CLAYTON. No, I think—would an investor take into account the regulatory situation and whether they are going to invest or not? Would they pay less if there is regulatory uncertainty? That is possible.

Mr. PERLMUTTER. I am asking a speculative question. I guess I will just ask it more directly. Have you personally run into any issues concerning the public offering of a marijuana business?

Mr. CLAYTON. Not that I recall, no.

Mr. PERLMUTTER. All right. Let's just broaden it now. Forget about marijuana. Is there any competition between the Canadian exchanges and the U.S. exchanges? Has that been where some of these IPOs have gone that the Chairman was concerned about?

Mr. CLAYTON. There is—to be clear—there is competition now around the world for listings. Where are you going to raise capital and where are you going to list your securities is a competitive business now. I don't know, but I would expect there would be competitive pressures in that industry.

Mr. PERLMUTTER. In your position, do you take a look at the limitations that say Canada may place on its public offerings versus what the U.S. does versus an Australian exchange?

Mr. CLAYTON. I do look at those, and it is a competitive question. But there is also—I am going to go in a direction that is slightly different. The investor protection regimes in other countries can be substantially different from what they are here, and I think a lot of times our investors look at if it is traded on XYZ Exchange and they think the investor protection is the same as if it is traded on one of our exchanges, and often it is not.

Mr. PERLMUTTER. Thank you. I yield back.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Illinois, Mr. Hultgren.

Mr. HULTGREN. Thank you, Chairman. Chairman Clayton, thank you so much for being here. I really do appreciate your work.

I want to begin by briefly thanking you for proposing a rule for independence with respect to certain loans or debtor-creditor relationships. As participation in the capital markets has expanded and as technology has changed business models, the opportunity to update regulations to reflect these changes is essential. I want to thank you for your movement on the loan rule and your willingness to provide clarification. Thank you so much for that. We look forward to working with you on that, as well.

CFTC Chairman Giancarlo has testified before the House that we have, and I quote, he said, "We have some anecdotal information that shows that during the recent market volatility the supplemental leverage ratio impacted larger market makers' ability to take on certain positions, thus exacerbating market volatility. The SLR is not specifically mandated in Title VII of Dodd-Frank and it has had the opposite effect intended, pushing trades away from central clearing," end quote.

The Treasury Department's October 2017 report on capital markets also acknowledged the issue. I wonder, do you share similar concerns for the equities options market? Have you shared these concerns about options market liquidity with banking regulators, given that they have rulemaking authority for the risk and leverage-based capital rules?

Mr. CLAYTON. The issue that you bring up is an important one. Our cash markets, the stock market, as is familiar to American investors, is actually connected to the options market. People who provide liquidity in our cash market use the options markets as part of their business. To the extent that liquidity drives up in the options market, it can cause a knock-on effect into the cash market.

This issue has been raised. I know that my fellow Federal financial regulators are aware of it, and I think we should continue to look at it.

Mr. HULTGREN. Great. Thanks. I am sure you heard, but the Committee unanimously reported legislation just last week that would direct our banking regulators to address the issue. Again, it was bipartisan, worked through and got unanimous support. Again, thank you, and just would encourage the SEC to continue to work with bank regulators, as well, on that.

I sent a letter last week to you raising concerns with FINRA rule 4210. In short, I am concerned that the margin requirements will push small to medium-sized dealers out of trading covered securities because of the competitive advantages to commercial banks and similar intermediaries that are not FINRA members. This is something we corresponded about last year, as well. I appreciate you providing a delay in the compliance date to spring of 2019.

However, I am continuing to hear serious concerns about the unlevel playing field that this would create. I wanted to ask, in general, do you believe FINRA has the authority to regulate credit markets? It seems to be what is happening with the new margin requirements on certain mortgage transactions covered under 4210. Then also, will the Commission consider changes to the rule or working more closely with the Fed to address unlevel playing fields between FINRA members and non-FINRA members?

Mr. CLAYTON. The last part of your question is the part I can give a direct answer to, which is, yes, I think we should. If there is an asymmetry in the costs of providing a service to clients, depending on whether you are in a bank or you are a standalone broker-dealer, we need to look at that.

Your other question, I do think FINRA has the authority to regulate broker-dealer conduct. To the extent margin requirements go into that, knock-on effects, et cetera, are a larger debate, but I will leave it at that.

Mr. HULTGREN. OK, thank you. In general, as my time is running down, I am interested in your views about the independence of the Financial Accounting Standards Board. It seems that the standard-setting body has drifted beyond the focus of the Commission and its staff in recent years.

I wonder, do you believe the SEC is exercising sufficient oversight over the FASB to ensure that accounting standards meet the needs of investors in the financial market? Is FASB conducting a rigorous and transparent view of new or modified accounting stand-

ards to make sure that there would be no detrimental impact on financial markets? For example, is a quantitative cost-benefit analysis of the standards conducted?

Mr. CLAYTON. I believe that high-quality financial statements—it is a combination of accounting standards and auditing standards that we have in this country—have been fundamental to the great capital markets that we have.

It is extremely important to me, it is extremely important to Wes Bricker, the head of the Office of the Chief Accountant, our Chief Accountant at the SEC. This is a focus not only inside the United States, but as U.S. investors have greater and greater exposure to non-U.S. companies, ensuring that those financial statements and those audits are on a level with ours. We are participating both nationally and internationally in that debate.

Mr. HULTGREN. Thanks, Chairman. I yield back.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Illinois, Mr. Foster.

Mr. FOSTER. Thank you, Chairman Clayton for being here. When we were discussing, prior to the start of your testimony, we discussed our shared enthusiasm for getting the consolidated audit trail implemented quickly and effectively.

I have a searing memory of, roughly 8 years ago in this room. Four days after the flash crash, we had testimony from the CFTC, which described that the evening after the flash crash they had 30 people in a room looking over all the trade records and knowing exactly who did what when.

On the other hand, 4 days after the flash crash, the SEC was still in the process of collecting the data, which to my mind made something like the consolidated audit trail an emergency. Here we are 8 years later, the consolidated audit trail, as you note in your testimony, was supposed to be at least initially operating in November 2017, and obviously that deadline was blown.

I was just wondering if you could describe where you think this is going and what you think Congress can expect as intermediate-term milestones in getting this thing operating as I think we both believe it should?

Mr. CLAYTON. Your question has embedded in it exactly what we have been trying to do since it became readily apparent that this was not going to be delivered on time or on spec, which is to require a work plan with milestones and goals. We now have a draft work plan from the SROs in front of us. It is long overdue. But we are now making progress with milestones.

Mr. FOSTER. Will you be able to share that work plan with Congress? Or at least a high-level summary of it in a memo?

Mr. CLAYTON. Yes, I think we can.

Mr. FOSTER. Milestones at least.

Mr. CLAYTON. I think we can find a way—look, I never like to answer a legal question without consulting. That is a bad habit I have—or a good habit—but I can find a way to give you a sense of the milestones.

Mr. FOSTER. Yes, milestones that Congress can track, so that we know whether we are just going to have another 8 years of little action.

Mr. CLAYTON. I have no problem with that kind of oversight.

Mr. FOSTER. OK. One of the trickiest parts of this is the beneficial owner behind each trade in the consolidated audit trail. From your testimony, you have had a lot of internal discussions about exactly what that should consist of and how it gets implemented. Can you describe your thinking on that? Particularly in view of the fact that a lot of the issues here are now international that you have correlated markets across the world and a lot of manipulation that you are worried about can happen internationally.

Mr. CLAYTON. Yes. We are talking about the two different functions of an audit trail. Going to the trading and the flash crash, having order types and the types of information that is contemplated by the consolidated audit trail is exactly what you would want from a market integrity, surveillance, functioning point of view.

When you turn to bad behavior and the ability to get at bad behavior, whether it is insider trading or manipulation and what you bring up is, are there things going on in some market outside of our purview that, when you connect them with things here, they revealed behavior that is bad when it would otherwise look fine? I think that is what you are—

Mr. FOSTER. That is one of the often cited dangers of the international markets we have.

Mr. CLAYTON. Yes, and the way we conduct this today is we see something that we don't like and then we inquire to get further information on who is behind those trades. The consolidated audit trail would make that process easier.

Mr. FOSTER. What is the status of international discussions, getting comparable information—well, are there comparable efforts fully internationally here? Are there big holes in that international cooperation that you would like to see patched? How do you see the international aspects of this going?

Mr. CLAYTON. International cooperation—here is my sense, no study, but my sense, a little over a year into the job, is international cooperation around what we will call manipulative or insider trading has increased significantly.

I will tell you that the legislation in Europe and here, it is—I have no problem with it—around information protection, individual information protection, GDPR in the E.U. and what we do here, getting through that in terms of cooperation around enforcement and surveillance is a task before us.

Mr. FOSTER. All right. Thank you, and my time is up.

Chairman HENSARLING. The gentleman yields back. The Chair wishes to inform members there are two votes pending on the floor. I will yield to one more member, and then we will recess and reconvene at the conclusion of floor votes.

The Chair now recognizes the gentleman from California, Mr. Royce, Chairman of the House Foreign Affairs Committee.

Mr. ROYCE. Thank you, Mr. Chairman. When we are looking at the proxy advisory industry, we have a stranglehold there, from my standpoint, we have two firms holding 97 percent of the market. What do you think the main causes of this lack of competition are? Is it good for the voting process? Is there anything the SEC can do in order to help jumpstart some competition in this industry?

Mr. CLAYTON. Let me say this, why only two firms? Just my knowledge of economics, economies of scale. The core function of those firms is aggregating data, crunching and producing data reports. You can see economies of scale coming to that.

Mr. ROYCE. I can see that it could lead to that outcome, but I do not know that it is in investors' interests not to have wider competition in the system. I do wonder if there are things we could do that might make it more likely that it would be a more competitive environment.

Mr. CLAYTON. The role that proxy advisory firms play is something we are looking at.

Mr. ROYCE. Yes. That is what I would suggest. I will ask you some other questions, as well, but just to have that on the table for your purview is important.

Mr. CLAYTON. They have a very important role in our regulatory ecosystem, and, therefore, we have to look at them.

Mr. ROYCE. Very good. Here is another question, Chairman, that I would raise to you. Earlier this year, this committee here passed legislation that would reverse a previous SEC rule requiring that certain money market funds float the NAV. Now, I certainly remember when the reserve fund in the industry broke the buck back in 2008. I remember the massive backstop that the U.S. taxpayers provided to restart the process for the entire market. This is not the only thing that caused that meltdown, but it was a factor after the overleverage of the GSEs and the overleverage in the investment banks.

The fact is that the value of the underlying assets of these products fluctuate. They go up and down. As I said in opposition to the bill at the time, if we learned anything from the financial crisis, it should be that price should reflect risk.

Six months have passed, yet the bill still seems to have some life. Do you stand by your comments from last year? Let me just ask you, has anything changed in your estimation from the comments that you made on this subject?

Mr. CLAYTON. No.

Mr. ROYCE. OK. That is good news, as far as I am concerned. Chairman, let me ask you, also—I Chair the Foreign Affairs Committee here—I have witnessed firsthand that we have state-sponsored agents now, actors that are looking to do our companies and our country harm through cyberattacks. The Commission clearly recognizes the problem with the updated interpretive guidance you have provided. We thank you for that.

Undoubtedly, companies have a duty to disclose when a material cyber security event has occurred. But what more should they be telling shareholders about cybersecurity risks? I think that is something that has to go into the equation. Have you noticed an uptick in the number of companies disclosing these risks or disclosing the attacks?

Mr. CLAYTON. I have, in my time focusing on this, I have noticed what I would consider to be—I will just say the word “improvement” in disclosure about the risk profile of companies and the types of risks they face from cyber intrusions. I think we are starting to see what I would say is more measured, and incident disclosure is more thoughtful. I hope our guidance is helping companies

with that. I want to continue to work with companies and the investing public on how we should be approaching this issue.

Mr. ROYCE. My time has expired. Thank you, Chairman.

Chairman HENSARLING. The time of the gentleman has expired. Pending conclusion of two votes on the floor, this committee stands in recess.

[Recess.]

Chairman HENSARLING. The committee will come to order. The Chair now recognizes the gentleman from Pennsylvania, Mr. Rothfus.

Mr. ROTHFUS. Thank you, Mr. Chairman. Welcome, Chairman Clayton. Thank you for taking the pause and the recess. Before I begin, I want to take a moment to address some of the comments that Congressman Royce made prior to the recess.

From my perspective, the problems caused by the SEC's rule changes respecting money markets remain an issue, because the problems they caused are still apparent. This rule discriminated against municipal and corporate debt and, in doing so, prompted the dislocation of a trillion dollars. This led to increased borrowing costs and caused an outcry in the municipal finance world.

That is why my bipartisan legislation attracted broad support from over 70 co-sponsors, many of whom sit on this committee, and the endorsement of over 300 National, State, and local organizations and public leaders. Nothing in my bill would undo the helpful 2010 SEC reforms that improved liquidity, increased credit quality, and shortened maturities. What it would do is restore the level playing field between prime, tax-exempt, and government funds.

This issue remains relevant and will continue to be relevant until the problem is fixed. I understand the Senate is actually going to be taking another look at this, this week.

But with that, I wanted to talk for a moment about your testimony. As you discussed in your testimony, there are still significant barriers that prevent companies from going public and staying public. The JOBS Act and successor legislation helped address some of these issues, but clearly there is more work that needs to be done.

I have a bill that we will mark up later day that would extend certain disclosure exemptions for emerging growth companies, or EGCs, that would remain EGC, but for the current 5-year limit. As you know, EGCs accounted for more than 90 percent of all IPOs over the last 2 years. Can you discuss some of the ways that we can help companies go public and stay public?

Mr. CLAYTON. Yes. Let me give you a general response to that question, which is, I do think the JOBS Act and the creation of the EGC concept for scaled disclosure and an on-ramp to being a public company was and remains a very good idea. I would love to see that on-ramp be modernized to reflect the markets we have today.

Specifically, are the thresholds where you have the benefit of being an EGC set in the appropriate place or should they reflect the markets of today and our experience with the JOBS Act? I think we should look at those thresholds. Happy to work with you and other members of this committee on setting them in the appropriate place.

Another thing that I just want to make sure I comment on, trading. Part of the attraction of going public is trading. To the extent that we can facilitate better trading, more liquid trading in our small- and medium-sized companies, I think we should be looking to do so.

Mr. ROTHFUS. Chairman Hensarling touched a little bit on Sarbanes-Oxley with his opening round. This legislation was enacted 15 years ago in response to Enron and WorldCom and the scandals that they had. In your opinion, has Sarbanes-Oxley been effective?

Mr. CLAYTON. It is interesting. A sweeping piece of legislation—to come to a single statement about any sweeping piece of legislation from a markets point of view is very difficult. There are aspects of Sarbanes-Oxley that I think investors got a significant bang for the buck. Independent audit committees, the focus on high-quality financial statements, that is a big bang for the buck. Some other things, good, but not as significant as those.

Mr. ROTHFUS. What components of Sarbanes-Oxley represent the biggest cost and/or compliance challenges for companies?

Mr. CLAYTON. I do think that from a—let me give you an example. We are going to be looking at 404, OK? 404 applied to a large company and 404 applied to a smaller company, the relative burden on the smaller company has been higher. I have seen improvements in the area of application of 404. But I do think that we should look at that relative cost to the size of smaller companies and intend to do so.

Mr. ROTHFUS. What is the timeframe for your review of 404? It is already started?

Mr. CLAYTON. Our staff is looking at 404 now. We are going to be discussing it—at least plans for discussion—at next Thursday's open meeting.

Mr. ROTHFUS. I yield back.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Maine, Mr. Poliquin.

Mr. POLIQUIN. Thank you, Mr. Chairman, very much.

Chairman Clayton, I am glad you could find me in this room. There are so many other people here now. But I am sure—this is only your second time before us, but I want to let you know, as Mr. Chairman knows, that he always saves the toughest questions for the end, but I am sure you and I can get through this, so I appreciate very much you being here.

I noticed that you folks over at the SEC have finalized Rule 30e-3, and I am very grateful, sir, that you and I had a back-and-forth many times on this, and you are going to be looking out for the interests of small savers and investors throughout the State of Maine and throughout rural America. I will be closely following this as the SEC implements its rule. But thank you very much for listening to my concerns.

You folks are the primary regulator, Mr. Clayton, for non-bank financial institutions like pension advisers. I worry a lot about our small businesses and our small savers and investors up in the State of Maine. On FSOC, you are one of 10 votes, and you are the individual as the regulator that has the most influence, I would believe, on FSOC because your space is the asset manager space when it comes to FSOC.

Now, what I am concerned about, Mr. Clayton, is that when a non-bank financial institution like a pension adviser or mutual fund company is designated FSOC or if it would be designated FSOC, we all know the studies that regs costs will go up, rates of return will go down. I think Doug Holtz-Eakin concluded that something like a 25 percent reduction over time is the result of being designated in a SIFI.

What drives me batty about this, sir, is that if you are in the asset management community, the assets that you are running, the assets that you have under management are not in your balance sheet. You are an agent for the customer. There is no systemic risk to the economy if something goes wrong, because it means that if my performance is better than yours, your clients will go from you to me and life goes on.

All I am asking you, sir, is to take a hard look at Ross-Delaney that passed this Congress on the floor, a big bipartisan vote, and obviously out of the Committee. It establishes transparency and clear guidelines such that a fund company or an asset manager, if they are concerned about being designated a SIFI and going through these additional regulations and costs, and the investors get hurt, because of those additional costs that are unnecessary, that there is an off-ramp, there is a set of guidelines that says, if I do this, I can get underneath this regulatory regime that is unnecessary.

Can I get a commitment from you today, Mr. Clayton, that you are going to be looking really hard making sure that there is transparency and clear guidelines when it comes to non-bank financial institutions being designated or not as SIFIs?

Mr. CLAYTON. I am not going to commit my other members of FSOC to a particular process—

Mr. POLIQUIN. No, but you have the most influence when it comes to this space on FSOC, I would argue.

Mr. CLAYTON. What I can say is I understand the comments you are making, I understand the concerns, and I am certain that those concerns and comments will be discussed by that group.

Mr. POLIQUIN. I would encourage you to discuss them in the most energetic and passionate way on behalf of those that should not be designated SIFIs. Thank you, sir.

Moving on to another issue, the last time the SEC updated its rules on promotion and advertisement when it comes to asset managers was—I think it was 1961. In 1961, Roger and I were just kids. I don't think, if I am not mistaken, the Internet and social media hadn't even been invented yet.

Will you take a look, sir, and commit today to the people listening that you will commit to taking another look at social media and the use of the Internet for asset managers to do what other companies do in this world, which is promote what they are selling?

Mr. CLAYTON. We are, and when we rolled out 30e-3, we also rolled out investor experience questions. We are looking at enhancing our communications with investors, and in particular, to make sure that investor communications reflect the communication technologies of today.

Mr. POLIQUIN. I hear that as a lean yes. Thank you very much, Mr. Clayton.

Last, in my remaining time here, Rule 14a-8, dealing with shareholder proposals, last time you were here, sir, we discussed this a little bit. Look, every shareholder has the opportunity to weigh in with management when it comes to how the company is being run, products offered and so forth and so on.

But a \$2,000 threshold, owning that for 1 year gives you an opportunity to express your views, I understand that. But it also drives up the costs, drives up what Mr. Hensarling said a short time ago about the hassles about going public, and I worry about every other small investor in Maine and in America that wants the opportunity to own part of America. Are you going to be looking at 14a-8, also, sir?

Mr. CLAYTON. I want to look at the whole proxy process, including 14a-8.

Mr. POLIQUIN. Thank you for that commitment, Mr. Chairman. Appreciate it.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Texas, Mr. Williams.

Mr. WILLIAMS. Thank you, Mr. Chairman. The last time you were here before this committee, you and I had a productive discussion about retail and affinity fraud. You mentioned that it was important to think creatively about ways that we can structure our behavior so that it is more difficult to commit fraud.

I am encouraged to hear that you have turned your attention to Main Street businesses that play such a critical role in our economy and in our local communities. My question, Mr. Chairman, since your last visit, can you provide any updates on retail fraud or any related tasks that your teams may be undertaking to target and prevent future fraud?

Mr. CLAYTON. We did form a Retail Fraud Strategy Task Force. I shouldn't say we. Our Division of Enforcement did. I appreciate that they have done that to focus on this. A group of people dedicated to rooting out retail fraud.

More importantly, there are a number of Ponzi schemes where we have identified them, brought asset freezes, and brought them to a halt, I would like to think as quickly as we could because the longer they go on, the more money that goes away, and the less money we can get back for investors. That has been a focus of ours.

The ICO space—let me preface this by saying like I do, the distributed ledger technology and blockchain technology, whatever you want to call it, has promise. But the ICO space has a great deal of retail fraud. I am very pleased that our Enforcement Division has pivoted to addressing that issue.

Mr. WILLIAMS. Thank you. Now, you yourself have rightly recognized that a vibrant IPO market allows Main Street investors to be able to participate in crucial growth process of growing. Can you touch on the role of the small business capital formation advocate office and what steps it will take to allow for growth in Main Street investor participation?

Mr. CLAYTON. Thanks for that question. Obviously, that office is new and will be—as any new office, it will find its way. It has some directions from Congress. What I really want, and when I am talking to candidates for that, I want somebody who when we are mak-

ing rules or a policy, says, “Hey, this is how this is going to affect the small business, so think about it when you do this.”

In particular, “You know what? This is too costly to apply to a small business.” Or, “This won’t help a small business. Here is how we could adjust the rule without adversely affecting investor protection or transparency.” It will be good to have somebody in the building where that is their job.

Mr. WILLIAMS. Last, you have a unique vantage point in your current role, one that requires you to work across several industries and countless stakeholders. If possible, can you give this committee your personal assessment on the health of the economy and what we should be concerned about or excited about?

Mr. CLAYTON. Health of the economy, that is out of my lane.

Mr. WILLIAMS. But it is good, I will tell you that.

Mr. CLAYTON. It is good.

Our job is to make sure that the markets function as well as they can to support our economy. There is always room for improvement in that. We come to work—not just me, we come to work every day looking to improve the functioning of our markets so the economy can be as good as it possibly can be.

Mr. WILLIAMS. Thank you. I have some time left. I yield back to the chairman.

Chairman HENSARLING. The gentleman yields back. The Chair now recognizes the gentleman from North Carolina, Mr. Budd.

Mr. BUDD. Thank you, Mr. Chairman and also Chairman Clayton. We are fortunate to have you at the helm. I guess that makes you captain of the ship, as we heard earlier, so we appreciate you being here and being our captain.

I wanted to get your views on some recent legislation that the Committee approved that would raise thresholds for shareholder resubmissions. It seems pretty straightforward in the simple proposal for the SEC to enact, and I think Mr. Duffy’s legislation offers a much more reasonable threshold that allows shareholders to have a voice, while not burdening public companies with proposals supported by a very, very small group of shareholders. While I strongly support this legislation moving forward, what can the SEC do to make these changes in the meantime?

Mr. CLAYTON. We can look at the proxy process, and I intend to look at that as part of an overall assessment of the proxy process. I think, if you don’t mind, I will take a minute.

Mr. BUDD. Please do.

Mr. CLAYTON. The ordinary investor, the retail investor, the Main Street investor, the people we think about, I think they should understand that corporate governance in America has changed substantially in the last decade as a result of various changes and that the ability of shareholders to directly influence the actions of management has increased.

Now, that has benefits. But it has been a change. We should be looking at that change and how it has changed the way corporations behave and, I think, communicate with American investors on what that change means.

Mr. BUDD. You mentioned looking at the proxy process. What timeline would you anticipate for the SEC looking at that process?

Mr. CLAYTON. We had an open comment period in the past. I am contemplating opening that again to get updates on this issue and other issues that are around the proxy process.

Mr. BUDD. Thank you.

Mr. CLAYTON. Including the plumbing. Do we have the right plumbing in light of—with the theme of modernization, do we have the right plumbing for the proxy process?

Mr. BUDD. Very good questions. I look forward to hearing the results on that.

Further, I want to switch over to virtual currencies for a moment, and it tag teams a little bit with Mr. Williams, my colleague, about investor fraud. Can you just tell me what criteria the SEC is using to determine which token projects should be targeted for enforcement actions? Then further, is that criteria focused on promises made by the developers of those token projects or is it focused on the expectations of purchasers, irrespective of any promises or marketing materials made by the developers of these projects, or some combination?

Mr. CLAYTON. Let me say what I am not going to do. I am not going to discuss allocations of enforcement resources to one particular type of bad activity versus another. If you are behaving badly in this market, we don't want you to do that.

In terms of what I would like people in this market to understand is that there is a way to raise capital that is compliant with the law. I want people in this space to recognize that and do that. If after a year of this dialog that we have been having people aren't moving to that, I have a problem with that.

Mr. BUDD. Noted. Thank you for your time, Mr. Chairman.

Chairman, I yield back.

Chairman HENSARLING. The gentleman yields back. The Chair now recognizes the gentlelady from New York, Ms. Tenney.

Ms. TENNEY. Thank you, Mr. Chairman. Thank you, sir.

I am always last in line, so hopefully I am not going to be too repetitive. I just have a couple of quick ideas. Obviously, in my region there has been this vilification of anyone who operates a so-called corporation or entity that seeks to look like a corporation, whether it is an S corp, a C corp, an LLC.

But in that realm, we have had a number of issues trying to get into the initial public offering space, and we appreciate your efforts in trying to move us more to an entrepreneurial ability and providing more capital formation and chances.

What do you think are the key steps that you are looking to take in addition to what you—I missed some of your testimony—what you may have said to getting us to get the smaller businesses and to assist the formation of capital and growth in an area, for example, where I am from in upstate New York, where we don't have the city next to us. We have small banks. We have fintech and others. How is SEC going to impact us, your new rules on helping us get there with some of our new businesses?

Mr. CLAYTON. I talked before about providing a path to being a larger company. Let's just stay in the smaller company space, I would like to see us modernize the accredited investor definition to make it easier for more people to participate in funding small businesses. I would like us to use technology to eliminate some of the

unnecessary frictions that go into raising capital on a smaller scale. Those are things that we are looking at.

In terms of availability of funds in different parts of the country outside of places that have a great deal of venture funding, I am hopeful that some of the things that we are doing in Volcker or proposed to be doing in Volcker will free some more local capital.

Ms. TENNEY. Have you seen any of that happening yet in any of the initiatives you have taken? Because I know, in my prior life before I got involved in this job in Congress, I had a lot of trouble getting some of my entrepreneurs to find investors, and they feared the IPO space a little bit because of just the rules, the regulations, and the SEC.

Can you identify a couple of things you are doing to simplify that and also if you have seen progress, if you have seen more IPOs coming forward in the small business space, is that something you have data on or something you can provide us with? Because I would love to know if what you are doing is actually helping. Are we actually moving more people into the space with data of some kind?

Mr. CLAYTON. Let me say this, I think a year is too early to tell. One of the issues about measuring success in this space is sometimes it takes a fair amount of time. The IPO process itself, from the time a company thinks about a public offering until they actually achieve a float, it starts long before they contact us, and it takes a while. That is a long-winded way of saying, I don't want to take credit for any uptick in IPOs, I don't want to say we are unsuccessful. I think we are doing the right things.

Ms. TENNEY. Yes, I believe you. I have been in the situation where I have taken my clients to other areas to try to find ways of getting them resources and getting them funding. I think that now it looks like we are in a better space than we were. I just was wondering if there is any demonstrable change.

Mr. CLAYTON. I think that we are in a better space than we were. It feels like we are in a better space. The activity that I am seeing, I like. Do I want to say, absolutely, here is some demonstrable evidence?

Ms. TENNEY. Next year you will have some more data for us when we get to that.

Mr. CLAYTON. I hope so.

Ms. TENNEY. I just want to jump to the whole cryptocurrency, bitcoin, everything, that is the excitement of the day, and what the SEC is doing about that. What are we going to be looking at as this becomes very popular and more and more investors and people are getting involved in the cryptocurrency? What is the SEC's reaction? Maybe if you could point out one or two things in the last 30 seconds about what you are doing in that, because I am running out of time.

Mr. CLAYTON. OK. In the pure cryptocurrency space, the examples that people cite are bitcoin or Ethereum. That is not in our direct jurisdiction, although there are issues with those crypto assets, including in the trading and what people use.

I want to be clear, to the extent that somebody is bringing those assets to a regulated entity of ours, that regulated entity needs to go through the same KYC, AML procedures. In the same token

space, I think we have raised the consciousness for people to understand that these are securities, and they need to follow our rules. I do think this technology has a lot of promise, and it can eliminate costs. I would focus on that. I am sorry.

Ms. TENNEY. Thank you. I am sorry, my time has expired. Thank you.

Chairman HENSARLING. The time of the gentlelady has expired. The Chair now recognizes the gentleman from Minnesota, Mr. Ellison.

Mr. ELLISON. Yes, thank you, sir, for joining us today, Mr. Chairman. Appreciate it.

Last year, Congress passed a multi-trillion dollar tax cut for—as you are well aware—and I think the theory behind it is as reported in the press and by some of my colleagues was that it would spur investment and thereby increase hiring for working people.

But some of the data has really come in, and according to the Bureau of Labor Statistics, wages for most workers, by 80 percent, are actually down since the tax cut passed. What are the companies doing with the windfall? I guess one of the things that the popular press indicates is that there has been a lot of stock buybacks. How do you react to that assessment?

Mr. CLAYTON. I don't have the data, but if what you are asking me, to be direct, is companies that have repatriated capital and are holding cash, what are they using that cash for?

Mr. ELLISON. Yes.

Mr. CLAYTON. To the extent they are using it for stock buybacks, what do I think about that? Is that—

Mr. ELLISON. I suppose that is what I am—yes.

Mr. CLAYTON. Stock buybacks are an efficient means to return capital to shareholders. They are more tax efficient than a dividend, for example.

Mr. ELLISON. OK.

Mr. CLAYTON. That is probably going into the judgment.

Mr. ELLISON. That is a policy that you support?

Mr. CLAYTON. Like I said—

Mr. ELLISON. You think it is a legitimate way to operate in light of—

Mr. CLAYTON. Here is what I think. If a company decides to do that, they should be telling the shareholders what they are doing with their money and do it in the most responsible way.

Mr. ELLISON. OK. In the first quarter of 2018 alone, corporations bought back a record \$178 billion in stock. According to a survey of major corporations, CEOs say that the stock buybacks are their number one use of capital. Instead of spending the money on wages or investment in research and development, they are going big into these stock buybacks, as you indicated.

I guess my question for you is, last week, your colleague, Commissioner Jackson, called on the SEC to revisit its stock buyback rule, which hasn't been revised in 15 years. Do you agree? Or how do you react to the suggestion that Commissioner Jackson made? Do you think it is a good time to open up for public comment the rule on stock buybacks?

Mr. CLAYTON. I asked Mr. Jackson what he meant because I think our rule around stock buybacks doesn't go to the decision of

whether you should do a buyback or not. In fact, it doesn't really go to the—we have rules that go to the disclosure of stock buybacks. I don't think he was talking about that.

I do think disclosure of stock buybacks is important. People who are shareholders should know whether you are buying back stock or using it for other things. But our rule goes to how you actually effect it in the market.

Mr. ELLISON. Given the time is wasting, I hope you will forgive me for cutting in.

Mr. CLAYTON. No problem.

Mr. ELLISON. Do you agree with Commissioner Jackson that the huge surge in stock buyback activity can lead to problems, particularly since the research shows that a substantial number of CEOs use buybacks to cash out their own shares?

Mr. CLAYTON. What is interesting is, executives sell stock on a regular basis, and they have to tell us. They have to file forms when they are selling stock. I am not sure about a connection between stock buybacks and executive selling, but what I want to make clear is that activity, it has to be disclosed to the marketplace so that we can look at it to see if there is any connection.

Mr. ELLISON. OK. Let me just tell you this. There is a report my office just recently drafted. I would like to share this with you and submit one for the record, without objection.

Mr. HILL [presiding]. Without objection.

Mr. ELLISON. Just so you know, in 1968, the average CEO made about 20 to 1, about 1980, about 34 to 1, now it is 339 to 1, but that hides a few facts there, Mr. Chairman. One, Mattel has nearly 5,000 to 1. McDonald's, 3,100 to 1, the Gap, 2,900 to 1, Walmart, 1,100 to 1. Are you concerned by those numbers?

Does that level of executive compensation create instability in the market? Isn't at least part of our income inequality problem because of the dramatic shift in how people are compensated?

Mr. HILL. The gentleman's time is expired. Quickly, you can respond.

Mr. CLAYTON. Quickly respond? I want to make sure that shareholders understand how people are being compensated and the criteria that go into making those decisions. How is the comp committee making those decisions? That is an important part of shareholder communications.

Mr. ELLISON. Thank you, sir.

Mr. CLAYTON. Thank you.

Mr. HILL. The gentleman yields back. The Chairman recognizes himself for 5 minutes.

Chairman Clayton, glad to have you before the Committee today. Thanks for your incredible stamina for being here today. We are glad to have your answers to all of our questions.

I wanted to start and talk about a FINRA rule, Rule 4210, which I have concerns about in terms of the fairness issue between bank-owned broker-dealers and nonbank-owned broker-dealers that relates to the agency's security market and posting margin for that. I won't debate with you today whether or not the SEC has the authority to impose margin requirements, thinking that perhaps the Reserve Act governs that.

But would you agree that we don't want to have public policy that on the face of it discriminates by organizational entity? In other words, in this example, bank-owned versus nonbank-owned broker-dealers?

Mr. CLAYTON. I agree.

Mr. HILL. Mr. Quarles when he was here representing the Federal Reserve, he agrees, as well. Would you be willing to work with the Federal Reserve to create a commonsense solution here that is fair to the brokerage community at large?

Mr. CLAYTON. Yes.

Mr. HILL. Thank you. I appreciate that.

Also, I have introduced a bill, H.R. 6021, which is of interest also to the brokerage community. This goes back to my days in the industry as an independent broker-dealer and a bank broker-dealer, as well, as it relates to small, privately held dealers that don't hold customer funds and are purely introducing brokers under the rules.

This goes all the way back to Sarbanes-Oxley, where all brokerage firms were required to have a public accounting oversight board qualified auditor, no matter their size or complexity. This bill, and Senator Cotton has introduced a companion in the Senate, would permanently waive that for small, private, noncustodial broker-dealers, something we got waivers for along the way between 2002 and recent years.

Is that something you think the Commission could support, knowing that they still fully comply with SEC rules, FINRA rules on audited financial statements in accordance with GAAP (generally accepted accounting principles)? Because the other thing I have learned in this process in the ensuing years is the number of qualified firms has dropped, something that I personally had not known until I started studying this issue.

Mr. CLAYTON. The short answer is yes. The longer answer is I like the criteria that you cited in terms of who we are talking about, and we have actually raised this issue with the PCAOB to get their views. I don't want to get ahead of them, but I expect their views would be that this is an area where we should question whether this is a necessary step. Particularly in light of the criteria you cited.

Mr. HILL. Thanks for that constructive nature. This hearing, this committee hears testimony all the time about tailoring regulations for community banks. It is weekly for 8 years, at least. We don't always pay attention to tailoring our rules through FINRA and through the Commission for our very small entrepreneurial broker-dealers, and yet the burden shift is very similar, so I appreciate your—

Mr. CLAYTON. Particularly those, like you said, that don't hold customer assets.

Mr. HILL. Correct. Yes, and let's be clear, again, just for our viewers, these are privately held companies that are introducing brokers, which means they clear all their securities through a clearing agent, and so they are not holding customer funds, because we are all sensitive to making sure that you oversee these entities in a safe and sound manner.

Mr. CLAYTON. Thank you for doing that because I just want to make clear, because that is a distinction that is very important to me.

Mr. HILL. It is. It is important to these members, but you would be—I don't think in any way—what I have seen is just audit fees have gone from maybe \$5,000 to \$8,000 a year for a typical GAAP small introducing broker that is overseen by FINRA at your direction, and some of those have tripled as the number of compliant accounting firms drops and the complexity of doing that exam goes up. I am not sure the Commission is getting concomitant big safety and soundness gains. Thank you for that.

Last topic I want to just introduce is one of my favorites, and that is how the Federal Government is trying to interpret the Volcker rule. The SEC has recently participated in the release of a Volcker 2.0. A lot of us up here found it very complex; I am not sure you made a big improvement there. Not you personally, but the collective agencies did. Are you going to be very diligent in looking at the comments for the Volcker rule re-proposal?

Mr. CLAYTON. Certainly, around the commentary, certainly. I think this is an area where the comments are going to be illuminating.

Mr. HILL. Thank you. I appreciate that. The chairman's time has more than expired.

I am going to now recognize the gentleman from West Virginia for 5 minutes, Mr. Mooney.

Mr. MOONEY. Thank you, Mr. Chairman. Chairman Clayton, thank you for coming here and taking all these questions and the good work you are doing there.

I wanted to make a comment and then a question. I want to add my appreciation for your leadership in proposing an expansive loan rule aperture. As private equity's role in the capital markets has expanded and as technology has changed business models, the opportunity to update regulations to reflect these changes is long overdue. Current regulatory impediments, they deter capital formation, they limit competition and decrease efficiencies. Just thank you for addressing this. That is very important.

I am from a rural area, West Virginia, and I think there is a misconception out there that investing in business startups and a lot of things we need in this country are for people in big cities or people with large bank accounts, but they are for people in rural areas, too. I would like for you to tell me the importance of capital formation to investments in workers in rural areas.

Mr. CLAYTON. All I can say is, I agree with you. The availability of capital, whether it is through investment or through credit, is essential to starting a business. That is just all there is to it. I agree.

Mr. MOONEY. I was at a fair about a year ago, and a young lady there had found a way in West Virginia to get syrup from trees. She started a small business to make this syrup and sell it. She was at a craft fair and she was showing her display there. She had the hardest time finding anyone to give her an initial startup loan to invest in this product. Went to banks, went to administrations, just couldn't find anybody to do it.

These regulations and restrictions, I think they are well intended by the other side, but they are hurting the people that need these

investment startup dollars. This is a family that had a dream in my district, and they can make it come true. It was a great product. I tasted it. They just couldn't find anyone to invest.

I just want to encourage you to continue this deregulation, get these impediments out of the way for Americans in rural areas, as well as cities, so they can have their dream of owning their own business come true.

With that, Mr. Chairman, I will go ahead and yield back the balance of my time.

Mr. HILL. The gentleman from West Virginia yields back the balance of his time.

The gentleman from Georgia, Mr. Loudermilk, is recognized for 5 minutes.

Mr. LOUDERMILK. Thank you, Mr. Chairman. Looks like maybe I am battling cleanup here today. I will try to keep this as brief as possible.

Thank you, Mr. Chairman, for being here, and taking this amount of time. It is very encouraging. I also want to thank you for your work in the best interest standard for brokers. I can tell you, every time I would be at home after the Department of Labor's fiduciary rule, I was inundated with brokers and those advisers with the confusion and the difficulty that this provided them. It was a significant impact, and I thank you for the work that you have done there.

Now, you stated that the slow pace of initial public offerings is a significant problem. With what I would call mind-boggling growth of our economy—GDP is up 3 percent, knocking at the door of 4 percent possibly. Wages are increasing. Consumer confidence is growing. Every statistic is way beyond anything that anyone ever anticipated we would be at 2 years ago. We are all celebrating that, or at least most of us are.

Because of all that growth, it may not be clear why the slow pace of IPOs is a problem. Can you explain why we're not seeing new initial public offerings in the light of a robust economy is a real concern?

Mr. CLAYTON. We just talked about the capital being essential to growth. The availability of capital is strong. We have private capital markets that are as strong as they have ever been, the availability of private capital to finance growth.

That said, it still does trouble me that our public capital markets are less attractive. I don't want to do anything to impede capital. I don't want to do anything to the private capital market in order to make the public capital market relatively better. This is a good thing, let's not do anything to it.

But broad participation in capital formation and investment in America is a good thing, and I want to make sure we continue to have broad participation, and the public capital markets are the most efficient way for ordinary Americans to get access to investment opportunities.

Mr. LOUDERMILK. I do agree with you. I just think there is a confusion with a lot of folks in that. How does this interact with the anticipated increase of mergers and acquisitions we are expecting?

Mr. CLAYTON. The number of companies in our public capital markets can be reduced for a number of reasons. People go private,

they merge, things like that. To the extent that pipeline isn't being filled, you have fewer choices. Now, when two public companies merge, you have a larger—

Mr. LOUDERMILK. Right.

Mr. CLAYTON. You don't lose capital in the public markets, but you do lose the numbers.

Mr. LOUDERMILK. OK. Let's move on to another topic, cryptocurrency, something I have been following for a while with an IT background. I agree that we have seen cryptocurrencies being used for nefarious purposes, money laundering, terrorism financing, human trafficking, drugs.

However, I believe the underlying technology of blockchain is something that we should pay close attention to, and I think we need to divest the cryptocurrency from the underlying technology. I have been advocating for us to look at the blockchain technology as a potential technology to resolve some of our cybersecurity concerns and issues. I just wanted to get your thoughts on that.

Mr. CLAYTON. I agree with you.

Mr. LOUDERMILK. OK. Thank you. Mr. Chairman, I yield back.

Mr. HILL. The gentleman from Georgia yields back. Now it is my pleasure to recognize my good friend from Connecticut, Mr. Himes, for 5 minutes.

Mr. HIMES. Thank you, Mr. Chairman.

Chairman Clayton, it is great to see you. Thank you for being here. I think I may be the last here, although you never know who is going to appear. But great to see you here.

I really want to just start by commending you. I read the testimony here, and this emphasis on Main Street investors and all that gives them confidence. I think that is a great approach. I really appreciate your intense focus on ICOs. To me, the frenzy in that space feels a lot like what I remember in 1999 and 2000 around the Internet space, and I think there is a real opportunity for people to get hurt, and so I really appreciate your focus and aggressive attention to that.

I want to bring up two topics, neither of which will surprise you, both of which I think are consistent with Main Street confidence, one indirectly, which is something I know we have talked about before, but my ongoing obsession with what I think is questionable behavior in the charging of fees and initial public offerings and the absolute perfect consistency of the 7 percent growth spread.

The reason I care about that, maybe it is not so much Main Street investors, but you tout the JOBS Act, and we are working on Jobs 2.0, and we are talking about saving young companies \$1 million, \$2 million, \$3 million max in their early stages, and an IPO of \$200 million with 7 percent growth spread, that is \$14 million. We are talking about very real money that comes at a very sensitive time for young companies.

Since we last talked about this, I have sent you a letter noting that one of your fellow Commissioners has taken an interest in this, and Mr. Eggers, who was before us, agreed with me that it didn't feel like competitive behavior.

Anyway, I sent you a letter and very much hope—I am not—again, I am not prejudging this, but I am saying there is enough there that we and FINRA and you need to take a look and make

sure that we have good, competitive market capitalism operating in IPO pricing. There is no question there, but—

Mr. CLAYTON. You and I share a passion for competitive markets.

Mr. HIMES. The letter makes a specific ask that you and FINRA study it. I am not going to hold you to that right now because I suspect you probably have just gotten the letter and are looking at it, but I do think it is important to young companies.

More to, again, consistent with Main Street investors—and this is really about Main Street confidence. I continue to be very concerned about what I regard as the legal ambiguity and mess around insider trading. I continue to be troubled by the fact that it looks like we have inconsistent, unpredictable, fuzzy law around insider trading, driven largely by decisions, some of which go with each other and some of which don't in the Second Circuit.

I would like to—there actually is a question attached to this speech—which is I would like to just hear you for a minute or 2 on whether you think the time is right for Congress to finally in statute define the crime of insider trading.

Mr. CLAYTON. You and I have talked about this. I have talked about it with people who are very experienced, including judges, people who hear the cases. There are arguments both ways on this. Bringing more certainty to the space eliminates some of the behavior that troubles you that you feel is not caught. I think if I am—I don't want to assume that you are—you are troubled by the fact that there is probably some behavior that you think should be sanctioned and isn't?

Mr. HIMES. Yes, but I am actually—in the spirit of Main Street—look, I am not a lawyer and I am not an expert on a lot of things, but I am an expert on public sentiment because that is what I do, and there is just a general sense out there with all the reversals of convictions and with all the activity in the Second Circuit in particular that we really have no idea what insider trading is, and somebody gets convicted and the conviction gets overturned. That in the aggregate is a huge source of uncertainty and therefore risk in the minds of individual investors who say, why should I play if I am at a disadvantage because I am doing this honestly?

Mr. CLAYTON. I understand that. I am not sure that a statutory approach would bring any more clarity. That is my issue. I am very happy to discuss it, look at it, but when you look at jurisdictions that do have a statutory approach, I am not sure that there is any greater clarity regarding behavior.

I can tell you—and, look, you know how I feel about this—I may be biased. When people bring me, when I was in the private sector, fact patterns, and would say, “Hey, what do you think about this activity,” it wasn't very hard to say I don't like that.

Mr. HIMES. OK, to be continued. Thank you very much, Mr. Chairman.

Chairman, I yield back the balance of my time.

Mr. HILL. The gentleman from Connecticut yields back. The gentleman from Ohio, Mr. Davidson, is recognized for 5 minutes.

Mr. DAVIDSON. Chairman, thank you so much for being here, and thanks for the work you and your team are doing at the SEC to make sure our capital markets stay the world's best. I especially appreciate the work you are doing on ICOs, and we will spend a

lot of time on that, hopefully, or what little time I have, with one sidebar.

Earlier this year, I introduced the Due Process Restoration Act, earlier this Congress. It relates to the SEC's use of administrative law judges. As you now know, the Supreme Court has ruled that this practice is unlawful, unconstitutional, and should not proceed. Could you give us any guidance or reaction to that decision?

Mr. CLAYTON. No, because I haven't read it.

Mr. DAVIDSON. Fair point. I look forward to working with the SEC on how to move forward and how might our existing law or bill, really, fit with the path forward.

Toward that end, our office is building what we hope to be the first ICO body of law in terms of clarity around the regulatory framework for ICOs, because I think a light-touch regulatory framework can do for our capital markets with ICOs what it has done on so many other things, provide certainty, provide clarity, and provide security, not just national security, but for protections against fraud.

I have been concerned that the disparate set of court opinions might not be as coherent as we would like or, frankly, the SEC would like, consumers would like, and in particular, investors would like. If the U.S. is going to truly be a world leader in this critical distributed ledger technology, I think we need to get this regulatory certainty.

To use an example of folks that have tried to do this, Ripple is just one of many digital assets that come to mind. I am aware there are numerous court cases regarding this company. Do you think it is prudent for Congress or the SEC to lead the way in clarifying what is a security or commodity, instead of waiting for the courts?

Mr. CLAYTON. I think, as regulators of the securities market, it is important for us to bring clarity to those markets. I do. But I think we are doing that.

We have turned to this space. We have issued guidance. The space is developing. But all of that guidance and our enforcement actions are rooted in a very well-tested approach to the raising of capital in the United States. I can't be more clear about this. I am not going to advocate for any fundamental changes in the way we raise capital to accommodate the technology. Now, the technology can make what we do more efficient, but I am not going to change the rules because we have a new technology.

Mr. DAVIDSON. Yes, fair point. The Howey test has been there, and I appreciate, frankly, Director Hinman last week clarifying that Ether is not viewed as a security. There had been some concern after some of your remarks that everything looks like it fits with the Howey test and—

Mr. CLAYTON. When you are raising capital for a project—

Mr. DAVIDSON. Right. As I think you and I agree, certainly many companies have essentially engaged in regulatory arbitrage and used white papers to raise more capital than they could through the existing framework. However, some companies—for securities. That body of law, I think you guys have taken an effective approach.

Mr. CLAYTON. We want to help people. Look, I am not saying do it, then—we want to help people—

Mr. DAVIDSON. You set up an office to be able to do that and equipped it with resources, so I appreciate that. One example, though, of people that have tried to follow like the Reg A+, that has a 90-day period where they are supposed to receive feedback, but there are companies that have gone well past 90 days at this point and they are waiting for a decision. Is that decision delayed because Reg A+ decisions are normally delayed? Or is that because we are going through a certain set of scrutiny for ICO-type companies?

Mr. CLAYTON. I am not aware of any specific facts, but I can tell you that the Reg A process, if somebody submits a deficient filing, is going to take longer than the usual period of time because you have to send it back to them and have them resubmit, as if it doesn't have financial statements.

Mr. DAVIDSON. Correct. It could be specific things, but I just want to highlight, you guys have made a way forward for people to comply with existing securities laws, and you have done good enforcement actions. I look forward to seeing how you move forward and look forward to continuing to cooperate to launch this legislative certainty.

My time is expired and I yield, chairman.

Mr. CLAYTON. Thank you.

Mr. HILL. The gentleman's time has expired. Now the gentleman from Nevada is recognized for 5 minutes.

Mr. KIHUEN. Thank you, Mr. Chairman, and thank you, Chairman Clayton, for being here this afternoon.

As you are aware, Las Vegas suffered the worst mass shooting in modern history last October 1st. Las Vegas is my hometown. I represent part of Las Vegas. Fifty-eight people lost their lives and over 500 people were injured.

My community, as you can imagine, is still trying to heal from this tragedy. Now, given Congress's refusal to take any efforts to prevent gun violence, we have seen many corporations step up, from Dick's Sporting Goods to Delta Air Lines. CEOs are rejecting those who say there is nothing we can do. I applaud them for leading corporate social responsibility and to help save lives and prevent gun violence in the future.

Now, like Congresswoman Maloney mentioned earlier, I would also like to talk a little bit about Citigroup. After the tragedy at Parkland a few weeks ago, Citi announced the new gun policies for their financial partners to require background checks and prohibit guns for teenagers. I know that you are familiar with those guidelines.

It is reported that in April, a Republican member of the SEC, Michael Piwowar, threatened Citigroup, saying that because of their private gun policies, the bank lacked support for their agenda at the SEC. Now, Republicans and Democrats can agree that no regulated entity like Citibank should be punished at the SEC.

I have a couple of questions, Mr. Chairman. Have you ever been contacted by anyone at the NRA about Citi or Bank of America gun policies?

Mr. CLAYTON. No.

Mr. KIHUEN. Never?

Mr. CLAYTON. I have been contacted—well, let me—

Mr. KIHUEN. In regards to this specific policy, that somebody will be punished if they follow background checks on their policies.

Mr. CLAYTON. No.

Mr. KIHUEN. OK. Have you ever spoken with Citigroup or Bank of America about their gun policies?

Mr. CLAYTON. No.

Mr. KIHUEN. OK. Have you ever discussed any company's gun policies with the SEC staff?

Mr. CLAYTON. Not that I recall.

Mr. KIHUEN. You have never had any conversation in regards to any gun policies with any of these entities?

Mr. CLAYTON. No, I am thinking because people have disclosures, they make disclosures, but have I—are you asking, like, gun policy in terms of SEC policy vis-a-vis gun policy?

Mr. KIHUEN. Absolutely, yes.

Mr. CLAYTON. No. No.

Mr. KIHUEN. Again, as I stated before, a Republican member of the SEC, Michael Piwowar, threatened Citigroup. This is back in April, saying that because of their private gun policies, that the bank lacked support for their agenda at the SEC. Not only is that unethical, that is illegal. I am asking you, as a chairman if you have ever had that type of conversation?

Mr. CLAYTON. That specific—that report and that incident, I am not going to discuss that. That has been a subject raised before, and as I said, the question of whether there should be an investigation is on the table, and it is inappropriate for me to discuss anything related to that subject. But as far as your other questions to me—

Mr. KIHUEN. Let me ask you this, are you aware of the gun policies?

Mr. CLAYTON. Yes.

Mr. KIHUEN. The new implemented gun policies?

Mr. CLAYTON. I mean, the—

Mr. KIHUEN. OK.

Mr. CLAYTON. When you say the gun policies, you mean the policies that private companies have adopted?

Mr. KIHUEN. Correct.

Mr. CLAYTON. Yes. Yes, I am aware of them.

Mr. KIHUEN. OK. Now, do you believe that Commissioners and staff should require greater ethics training to prevent this type of conflict of interest from happening in the future?

Mr. CLAYTON. I think that touches on what we talked about. I am not going to comment on that in this forum at this time.

Mr. KIHUEN. OK. Now, I understand that an IG investigation has been requested. Will you agree to fully cooperate with this investigation?

Mr. CLAYTON. I always cooperate with the IG investigations.

Mr. KIHUEN. Thank you, Mr. Chairman.

Last, I just want to, again, thank you for being here. Thank you for being so patient with all of us. I hope that this is addressed and that our regulatory agencies, including the SEC, are not threatening private companies on behalf of the NRA or any other special

interest group, because again, as I said, it is not only unethical, but it is also illegal.

Thank you, Mr. Chairman. I yield the remaining balance of my time.

Mr. HILL. The gentleman from Nevada yields the balance of his time. That concludes our hearing.

I want to thank the patience, as the gentleman from Nevada noted, of our witness, and appreciate his testimony today. The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

[Whereupon, at 1:24 p.m., the committee was adjourned.]

A P P E N D I X

June 21, 2018

**Testimony on “Oversight of the U.S. Securities and Exchange Commission”
by
Jay Clayton
Chairman, U.S. Securities and Exchange Commission**

**Before the
Committee on Financial Services
U.S. House of Representatives
June 21, 2018**

Chairman Hensarling, Ranking Member Waters and members of the Committee, thank you for the opportunity to testify today about the work of the U.S. Securities and Exchange Commission (SEC).¹

With a workforce of over 4,500 staff in Washington and across our 11 regional offices, the SEC oversees, among other things (1) approximately \$82 trillion in securities trading annually on U.S. equity markets; (2) the disclosures of approximately 4,300 exchange-listed public companies with an approximate aggregate market capitalization of \$30 trillion; and (3) the activities of over 26,000 registered entities and self-regulatory organizations. These registered entities and registrants include, among others, investment advisers, broker-dealers, transfer agents, securities exchanges, clearing agencies, mutual funds and exchange-traded funds (ETFs), and employ over one million people in the United States.

Since arriving at the Commission, I have been working with my fellow Commissioners and the SEC’s dedicated staff to pursue an agenda that advances the agency’s mission—to protect investors, maintain fair, orderly and efficient markets and facilitate capital formation. As we pursue that tripartite mission, I believe we should focus on the interests of our long-term Main Street investors.²

My interactions with the SEC staff over the past year have demonstrated unequivocally that the women and men of the SEC place the interests of our long-term Main Street investors first. We recognize, and are motivated by, the fact that tens of millions of Americans are invested in our securities markets and have to make personal investment decisions—both direct decisions such as which stocks, bonds, mutual funds, ETFs and other securities to purchase and indirect investment decisions such as which broker-dealer or investment adviser to hire. Many Americans are also invested in our markets through pension funds and other intermediaries. Main Street investors benefit from investment opportunities, fair and efficient markets and, importantly, investor protection. In turn, we believe serving these interests furthers America’s broad interests.

¹ The views expressed in this testimony are those of the Chairman of the Securities and Exchange Commission and do not necessarily represent the views of the President, the full Commission or any Commissioner.

² My remarks in connection with our recent Investor Advisory Committee in Atlanta discussed in detail this principle—focusing on the interest of our long term Main Street investors—and the steps we have taken to further those interests. See Remarks to the SEC Investor Advisory Committee (June 14, 2018), *available at* <https://www.sec.gov/news/public-statement/clayton-statement-investor-advisory-committee-061418>.

It is our Main Street investors, and their willingness to commit their hard-earned money to our capital markets for the long term, who have ensured that the U.S. capital markets have long been the deepest, most dynamic and most liquid in the world. Their capital provides businesses with the opportunity to grow and create jobs and supplies the capital markets with the funds that give the U.S. economy a competitive advantage. In turn, our markets have provided American Main Street investors with better investment opportunities than comparable investors in other jurisdictions. We should strive to maintain and enhance these complementary positions, including by being mindful of emerging trends and related risks.

The historic performance and strength of our markets is even more striking when viewed in comparison to world markets and world population. The U.S. population is only approximately 4.4 percent of global population, but of the world's 100 largest publicly traded companies, 53 are U.S. companies, representing 62 percent of the total market capitalization of those top 100 companies. These figures demonstrate the historic importance of our capital markets to the America economy and the American people and also demonstrate that our relative contribution to the global economy is a remarkable, long-term achievement that has been driven, to a significant extent, by our capital markets.

More significantly, at least 51 percent of U.S. households are invested directly or indirectly in our capital markets.³ This level of retail investor participation stands out against other large industrialized countries. When I engage with my international counterparts, they make it clear that they would like to replicate our capital markets' broad retail investor participation for many reasons, including the competitive advantage it provides to our economy and how our capital markets have made a broad cross section of Americans' lives better. This level of investor participation, opportunity and protection has been a decades-long endeavor involving the SEC, other regulators and market participants and should not be taken for granted.

Our New Strategic Plan

The principles I have discussed—most notably the interests of our long-term Main Street investors—are integrated in our new strategic plan. With input from my fellow Commissioners, Kara Stein, Michael Piwowar, Robert Jackson, Jr. and Hester Peirce, as well as many dozens of my colleagues at the SEC, the SEC recently published a new, multi-year strategic plan that will establish a framework for the future of the agency.⁴

³ See Jesse Bricker et al. (2017), "Changes in U.S. Family Finances from 2013 to 2016: Evidence from the Survey of Consumer Finances," Federal Reserve Bulletin, vol. 103 (September), available at <https://www.federalreserve.gov/publications/files/scf17.pdf>; see also Rel. No. 34-83063, *Form CRS Relationship Summary: Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the use of Certain Names or Titles* (Apr. 18, 2018) (for statistics except the mutual fund data); 2018 Investment Company Fact Book (ICI, 58th ed. 2018) (mutual fund statistics).

⁴ See U.S. Sec. and Exch. Comm'n Strategic Plan: Fiscal Years 2018-2022, Draft for Comment (June 2018), available at <https://www.sec.gov/files/sec-strategic-plan-2018-2022.pdf>. The SEC's plan was prepared pursuant to the Government Performance and Results Act (GPRA), as amended, which requires agencies to publish a strategic plan once every four years (see 5 USC § 306).

The plan, which is available on our website for public comment, re-affirms the SEC's tripartite mission and the values that unite us in our work, while also providing a strategic vision and path that describes where we want to be in the future and how we expect to get there. The key priorities include (1) our commitment to Main Street investors; (2) a focus on being innovative, responsive and resilient to developments and trends in the markets; and (3) using technology, data analytics and human capital to improve our performance and manage our internal resources and risks. We are looking forward to the additional insights we will gain from our various constituents as we finalize the plan in the coming months. I welcome your comments on the strategic plan.

Fiscal Year 2018 Developments

These principles set forth in our strategic plan are embodied in our near-term Regulatory Flexibility Act rulemaking agenda.⁵ When the agenda was published, I noted that it was shorter than prior agendas and was so, principally, because it reflected what I expected us to complete during the year.⁶ We have made significant progress since the Fall 2017 Agenda, and I would like to now highlight several of the SEC's accomplishments over the past months.

Facilitating Capital Formation and Investment Opportunities

In executing the SEC's tripartite mission, we seek to promote a market environment conducive to capital formation while ensuring that our markets are fair and resilient and our investors remain well protected. As I have noted on many occasions, facilitating capital formation, particularly with an eye toward encouraging promising emerging companies to enter our public capital markets, has been a focus for the past year. While progress has been made, I believe we can and should do more to facilitate capital formation in our public and private capital markets and, particularly, for small and emerging companies.

Fewer promising emerging companies are choosing to enter our public capital markets than in the past, and, as a result, equity investment opportunities for Main Street investors are more limited. There has been much debate about the causes and effects of this trend, but from my perspective, having a broader portfolio of quality public companies—especially those at the earlier stage of their growth cycle—ultimately will have positive results for our Main Street investors. Because it is generally difficult and expensive for Main Street investors to invest in private companies, they will not have the opportunity to participate in the growth phase of these companies to the extent they choose not to enter our public markets or do so only later in their life cycle. Additionally, it is my experience that companies that go through the SEC public registration and offering process often come out as better companies, providing net benefits to the company, investors and our capital markets.

⁵ See U.S. Sec. and Exch. Comm'n, Agency Rule List (Spring 2018), available at https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST¤tPub=true&agencyCode=&showStage=active&agencyCd=3235&Image58.x=84&Image58.y=13&Image58=Submit.

⁶ Over the past 10 years, the Commission has completed, on average, only a third of the rules listed on the near-term agenda. As examples, 18 rules were listed as to-be-adopted in 2008, and 32 rules were listed in the same category for 2016; in each case, about 27 percent of the rules were adopted in each year.

While there is no silver bullet to counter the negative trend in the number of U.S. public companies, we will continue working to enhance capital formation opportunities without sacrificing the important investor protections our public company disclosure system has provided for over 80 years. Part of the solution, however, is to recognize that a one size regulatory structure for public companies does not fit all. The Jumpstart Our Business Startups (JOBS) Act helped create an ecosystem whereby scaling disclosure and other regulatory requirements provided incentives for companies to conduct public offerings while maintaining the world's most robust investor protection environment.

Over the past year, our Division of Corporation Finance (Corporation Finance), under the direction of Bill Hinman, has carried out several key initiatives with a particular emphasis on capital-raising opportunities, which I will highlight below. We also are working to identify the Commission's first Advocate for Small Business Capital Formation, who will provide additional leadership in helping small issuers raise capital.

Simplifying the Public Capital-Raising Process

Corporation Finance simplified the capital raising process for first-time registrants and newly public companies by expanding the confidential submission process, which provides for non-public review of certain securities offerings, including for initial public offerings (IPOs) and offerings within one year of an IPO, allowing newly public companies to raise capital with less exposure to market volatility, which benefits them and their investors.⁷ Corporation Finance also provided greater clarity about what financial information is required when submitting draft registration statements so companies can avoid the time and expense of preparing and filing interim financial information that will be superseded by the time the filing is first made publicly available.⁸ These accommodations appear to be making a positive difference for issuers; according to reports, the amount of time that it has taken for issuers to price their offerings after publicly posting their registration statement information has dropped.⁹ This gives issuers more control over their offering schedules and limits their exposure to market volatility. At the same time, we continue to devote significant staff resources to reviewing filings for compliance with the rules that require companies to provide investors key financial information and other required disclosures.

Corporation Finance has also been encouraging companies and investors to approach our staff about impediments to raising capital and pursuing novel transactions. For example, there are circumstances in which the Commission's reporting rules may require publicly traded companies to file financial statements for other entities, such as a probable business acquisition. However, for some transactions this information is clearly not material to the total mix of

⁷ See *Draft Registration Statement Processing Procedures Expanded*, Division of Corporation Finance Announcement (June 29, 2017) [Supplemented Aug. 17, 2017], available at <https://www.sec.gov/corpfin/announcement/draft-registration-statement-processing-procedures-expanded>.

⁸ See Securities Act Forms Compliance and Disclosure Interpretation 101.04 and 101.05, available at <https://www.sec.gov/divisions/corpfin/guidance/safileinterp.htm>.

⁹ See Brandon Kochkodin and Alex Barinka, *IPO Timelines Are Cut by 80% After SEC's Private Filing Decision*, Bloomberg (Dec. 22, 2017), available at <https://www.bloomberg.com/news/articles/2017-12-22/ipo-timelines-are-cut-by-80-after-sec-s-private-filing-decision>.

information available to investors and is burdensome and costly to generate. Under Rule 3-13 of Regulation S-X, issuers may request and the Commission may grant modifications to their financial reporting requirements in these situations and where consistent with investor protection. Corporation Finance staff are placing a high priority on responding to these requests with timely guidance.

With regard to future Commission actions, I anticipate that the Commission will soon consider adopting final amendments to the “smaller reporting company” definition, which would expand the number of issuers eligible to provide scaled disclosures. In light of comments received during that rulemaking process, we are also taking a fresh look at the thresholds that trigger the requirement contained in Section 404(b) of the Sarbanes-Oxley Act to have an auditor provide an attestation report on internal control over financial reporting.

Corporation Finance also is exploring additional ideas to encourage more companies to enter our public equity markets. For example, the JOBS Act provided an exemption for Emerging Growth Companies (EGCs) to communicate with potential investors prior to or following the filing of a registration statement to “test the waters” for an offering, and our current near-term agenda includes a proposal to extend the “test the waters” provision to non-EGCs.

Improving Disclosure Effectiveness

Another important component of improving our public company regulatory regime is Corporation Finance’s initiative to improve public company disclosure by reviewing our disclosure requirements and considering ways to improve the disclosure regime for the benefit of both investors and companies. I believe we should regularly review whether we have disclosure requirements that are outdated, duplicative or can otherwise be improved.

In October 2017, the Commission proposed amendments, as required by the Fix America’s Surface Transportation (FAST) Act, to modernize and simplify certain disclosure requirements in Regulation S-K and related rules and forms in a manner that reduces the costs and burdens on registrants while continuing to provide all material information to investors.¹⁰ Corporation Finance is preparing recommendations for the Commission to finalize these amendments. Further, Corporation Finance is developing recommendations for updating certain Industry Guides to modernize industry-specific disclosure requirements, specifically for mining and bank holding company issuers. Corporation Finance is also developing recommendations for final rules to update and simplify disclosure requirements that may have become outdated, overlapping or duplicative with other Commission rules or U.S. GAAP.

Corporation Finance is developing recommendations for the Commission for proposed changes to the requirements in Rules 3-05, 3-10 and 3-16 of Regulation S-X (which provides requirements for financial statements) to improve those requirements for both investors and registrants. While our disclosure requirements in Regulation S-K (which provides requirements

¹⁰ See Press Release 2017-192, *SEC Proposes Rules to Implement FAST Act Mandate to Modernize and Simplify Disclosure* (Oct. 11, 2017), available at <https://www.sec.gov/news/press-release/2017-192>.

for public company disclosure) often receive more attention, many Regulation S-X rules are more prescriptive and more costly for issuers. I anticipate that Corporation Finance's work in this area will yield significant benefits for public issuers without adversely affecting the availability of material financial information or adversely affecting investor protection.

Exempt Offerings and Small Business Initiatives

As the number of public offerings has declined, a significant and growing amount of capital is being raised pursuant to non-registered offering exemptions. Congress and the Commission have taken notable steps in recent years to further develop a capital formation ecosystem that includes a scaled disclosure regime and provides small- and medium-sized businesses additional capital raising avenues while maintaining robust investor protections.

Since the Commission adopted amendments to Regulation A in 2015, the number of qualified offerings and the aggregate amount sought in those offerings has substantially increased relative to the pre-amendment numbers. Eighty-nine issuers in 221 qualified offerings raised a total of approximately \$798 million through March 31, 2018. I directed the staff to continue monitoring this market and gathering additional information about the use of Regulation A by issuers, investors and other market participants. I also requested that the staff accelerate the next statutory review of the current Regulation A offering limit to 2019. Further, enacted last month, the Economic Growth, Regulatory Relief, and Consumer Protection Act requires the Commission to amend Regulation A to allow reporting companies to use the exemption, and that rulemaking project is underway.

In addition to Regulation A, in 2017, \$147 billion was raised using Rule 506(c), which permits the use of general solicitation in exempt offerings. We are also seeing early-stage businesses use crowdfunding as a securities offering method. Between May 2016, when Regulation Crowdfunding went into effect, and March 2018, there were 778 offerings initiated under the regulation's exemption, with a reported total amount raised of \$68.7 million.

As the exempt offering market grows and evolves, the SEC staff continues to monitor developments, gather and examine data and assess the effectiveness of these new exemptions in terms both of their ability to raise capital for smaller companies as well as providing appropriate protections for investors in these markets. Staff will be conducting reviews of the impact of Regulation Crowdfunding and Regulation A on capital formation and investor protection and will provide recommendations to the Commission.

The Economic Growth, Regulatory Relief, and Consumer Protection Act also requires the Commission to revise Securities Act Rule 701, which provides an exemption from registration for securities issued by non-reporting companies pursuant to compensatory arrangements. Specifically, the Commission is required to increase from \$5 million to \$10 million the aggregate sales price or amount of securities able to be sold during any consecutive 12-month period before an issuer is required to deliver additional disclosures to investors. Work on that rule amendment is underway, and staff is considering additional ways that Rule 701 might be modernized.

We recognize that as new and enhanced exemptions provide additional avenues for capital formation, small companies and their investors also could benefit from reduced regulatory complexity. Corporation Finance is considering ways to harmonize and streamline the Commission's exempt offering rules in order to enhance their clarity and ease of use.

Shareholder Engagement and the Proxy Process

Given the core role of the proxy process in public company governance, I believe the Commission should examine this area to determine whether the needs of shareholders and companies are being adequately and efficiently addressed. Over the years, participants in the proxy process—companies and shareholders alike—have expressed concerns about a variety of proxy matters. In 2010, the SEC solicited input on several proxy matters in a concept release on the U.S. proxy system.¹¹ It is clear that opportunities for improvement exist, and I am interested in obtaining updated feedback on the 2010 “Proxy Plumbing” concept release from market participants.¹²

There are a number of issues that this should address, including the quality and mix of information provided to shareholders and how that information is provided, shareholder proposals, the role of proxy advisory firms and the costs and burdens of the proxy system on companies and shareholders. One area in particular I believe we should analyze is whether the voices of long-term retail investors are being underrepresented, misrepresented or selectively represented in corporate governance.

Cybersecurity

As a general matter, it is critical that investors be informed about the dependence of our economy on the storage, transmission and protection of data and the related material threats that issuers, market participants and our markets themselves face. The Commission recently provided greater clarity on disclosure obligations related to cybersecurity. In February 2018, the Commission issued a statement and interpretive guidance to assist public companies in preparing disclosures about cybersecurity.¹³ This guidance provides the Commission's views about public companies' disclosure obligations under our laws and regulations with respect to matters involving cybersecurity risk and incidents. It also describes the importance of comprehensive policies and procedures related to cybersecurity events. This includes appropriate disclosure controls and having insider trading policies and procedures that guard against corporate insiders trading during the period between a company's discovery of a cybersecurity incident and public disclosure. It also addresses the importance of selective disclosure prohibitions in the cybersecurity context. We are continuing to examine whether public companies are taking appropriate action to inform investors about material cyber-related information, including after a

¹¹ *Concept Release on the U.S. Proxy System*, Release No. 34-62495 (July 14, 2010) [75 FR 42982 (July 22, 2010)].

¹² See Remarks at the PLI 49th Annual Institute on Securities Regulation (Nov. 8, 2017), available at <https://www.sec.gov/news/speech/speech-clayton-2017-11-08>.

¹³ See Press Release 2018-22, *SEC Adopts Statement and Interpretative Guidance on Public Company Cybersecurity Disclosures* (Feb. 21, 2018), available at <https://www.sec.gov/news/press-release/2018-22>.

breach has occurred, and we will investigate issuers that mislead investors about material cybersecurity risks or data breaches.

In the area of enforcing our disclosure rules and their application to cyber intrusions, we recently announced charges against the company formerly known as Yahoo! in the first enforcement action that the Commission has brought against a public company for disclosure failures relating to a cyber breach.¹⁴ As one of the Co-Directors of our Enforcement Division said, companies can face difficult choices when deciding whether and how to disclose information about cyber incidents, and we should hesitate before second-guessing reasonable judgments on these issues.¹⁵ But the Yahoo! case should serve as an example that, in today's world, companies must have adequate policies and procedures in place to ensure that they respond appropriately to—and, where necessary, adequately disclose—material cyber risks and incidents.

Turning to cybersecurity at the SEC, in August 2017, shortly after my arrival at the Commission, I learned about an intrusion into the SEC's EDGAR system that occurred in 2016. We promptly disclosed this intrusion to the public and this Committee.¹⁶ As you may recall, the intrusion concerned the test filing component of our EDGAR system. The intruders gained unauthorized access to EDGAR filing information that was not yet public, which may have provided a basis for illicit trading.

Upon learning of this intrusion last August, after consulting with my colleagues, I initiated a number of different work streams to assess the nature, cause and scope of the intrusion; the potential factors that may have led to the intrusion; the agency's response at the time; and the extent to which cybersecurity enhancements are needed at the SEC.¹⁷ Personnel from across the agency—including members of the Office of Information Technology (OIT), Division of Enforcement (Enforcement), Office of the General Counsel (OGC) and the Office of the Inspector General (OIG)—as well as outside advisors and other authorities,¹⁸ have been

¹⁴ See Press Release 2018-71, *Altaba, Formerly Known as Yahoo!, Charged With Failing to Disclose Massive Cybersecurity Breach; Agrees To Pay \$35 Million* (Apr. 24, 2018), available at <https://www.sec.gov/news/press-release/2018-71>.

¹⁵ See also Remarks at the Economic Club of New York (July 12, 2017), available at <https://www.sec.gov/news/speech/remarks-economic-club-new-york> (“Being a victim of a cyber penetration is not, in itself, an excuse. But, I think we need to be cautious about punishing responsible companies who nevertheless are victims of sophisticated cyber penetrations. Said another way, the SEC needs to have a broad perspective and bring proportionality to this area that affects not only investors, companies and our markets, but our national security and our future”).

¹⁶ See Press Release 2017-170, *SEC Chairman Clayton Issues Statement on Cybersecurity: Discloses the Commission's Cyber Risk Profile, Discusses Intrusions at the Commission, and Reviews the Commission's Approach to Oversight and Enforcement* (Sept. 20, 2017), available at <https://www.sec.gov/news/press-release/2017-170>; Statement on Cybersecurity (Sept. 20, 2017), available at <https://www.sec.gov/news/public-statement/statement-clayton-2017-09-20>; Testimony on “Examining the SEC's Agenda, Operation, and Budget” (Oct. 4, 2017), available at <https://www.sec.gov/news/testimony/testimony-examining-secs-agenda-operation-and-budget>.

¹⁷ See Testimony on “Examining the SEC's Agenda, Operation, and Budget,” *supra* note 16.

¹⁸ For example, OGC has retained an outside technology and cybersecurity consultant with extensive expertise in cyber intrusion investigations, and OIT has engaged outside technology and cybersecurity experts to advise on cybersecurity uplift efforts.

involved in these efforts. We have made progress on these fronts; and while much remains to be done, I believe it is appropriate to provide a brief update on the status of our work.

OGC has informed me that its internal review of the 2016 intrusion is in its final stages. Upon its completion, I expect to provide this Committee with additional information resulting from that review. The OGC review is focused on understanding the nature, cause and scope of the intrusion.

With regard to the 2016 intrusion itself, we believe that cyber threat actors were able to exploit a defect in our EDGAR system and access information in certain test filings (*e.g.*, from a company checking the formatting of a draft earnings release to be filed on a Form 8-K) before the information became public through a subsequent live filing. Enforcement continues to investigate potential illicit trading that may be related to the intrusion.

As a result of this review, technical, process and organizational deficiencies were identified. It appears that these deficiencies, taken together, contributed to internal delays in both the recognition of the intrusion itself and the internal appreciation of its scope and impact. We are working hard to address these issues. Although substantial work remains to be done, I will outline our principal efforts to date.

- *Governance and oversight.* The OGC review has identified the need for better IT governance and oversight. We have created a new enterprise-level position of Chief Risk Officer, which will be responsible for coordinating efforts to identify, monitor and mitigate risks across the agency.¹⁹ We are in the process of reorganizing our IT security office to provide additional resources in our cybersecurity operations branch, including additional management personnel to provide dedicated focus and expertise. In addition, we have launched an initiative to install Information System Security Officers in various functions to facilitate and improve collaboration between information system owners and business personnel, and to help ensure that each information system has operational security commensurate with the sensitivity of its information.
- *Security controls.* The OGC review has made it clear that the SEC would have benefitted from more robust preventative and detective cybersecurity controls, and we are working to improve our control environment. The reorganization described above is designed to provide for increased focus on preventative and detective security and controls. Our new standalone EDGAR Business Office, established in 2017, has been working with OIT to implement technological enhancements and improve security monitoring, protections and compliance. On that front we have made technological enhancements, including to our security monitoring processes, and implemented additional data protection technologies.

¹⁹ We have named Julie Erhardt as the acting Chief Risk Officer while we complete our search. Julie is a Deputy Chief Accountant at the agency and has an M.S. in management from Stanford University. Through her 14 years at the Commission and prior work as an auditor, Julie has substantial experience in internal controls, auditing and risk management.

We have expanded our use of penetration testing on our systems, including EDGAR, and we have undertaken additional efforts to analyze EDGAR's source code. In addition, we are working with outside experts and have partnered with other government agencies to assess the SEC's critical systems more broadly.

- *Risk awareness.* The OGC review also makes it clear that SEC could have benefitted from improved awareness across the agency of the sensitivity and risks related to data collection and storage. We have enhanced cyber-incident information sharing across Enforcement, OIG and OIT, and we have improved reporting protocols for cyber security risks and exposures.

It is very important to me to foster a culture that recognizes the great responsibility we have with respect to the data entrusted to us by our registrants and the public. We are closely scrutinizing how we can reduce any potential exposure of personally identifiable information contained in SEC systems, including EDGAR. In this regard, earlier this year, the Commission has acted to eliminate the collection of social security numbers and dates of birth on a number of EDGAR forms where we concluded that the information was not necessary to our mission.²⁰

Similarly, with respect to market sensitive data, we are looking into whether we can reduce the data we take in or reduce its sensitivity (including, for example, by taking certain market sensitive data in on a delayed basis). For our systems that hold sensitive data, we have engaged an outside expert to help us assess our efforts to secure those systems.

- *Incident response.* The OGC review highlighted the need to ensure that we have comprehensive incident response and escalation plans in place. We have revised the agency's incident management plan, which addresses reporting procedures and escalation protocols for cyber security events or incidents, and we expect to further improve the plan as we test it. And we have conducted multiple cyber incident response exercises to help prepare appropriate decision makers for various threat scenarios.
- *Legacy systems.* The OGC review confirmed that we need to continue and improve upon our efforts to modernize key legacy information systems, especially EDGAR, and address risks associated with bespoke systems. We have increased the focus and resources on our legacy systems, particularly with respect to maintenance and replacement of those systems. The increased funding provided to us by Congress for fiscal year 2018 will allow us to accelerate our transition away from certain legacy systems and functionalities towards systems that have additional security enhancements.

To be sure, no system can be 100 percent safe from a cyber intrusion, particularly in a world where cyber threat actors are backed by substantial resources. More needs to be done to strengthen the SEC's cybersecurity posture. Indeed, our uplift efforts have revealed additional

²⁰ Amendments to Forms and Schedules To Remove Provision of Certain Personally Identifiable Information, Rel. Nos. 33-10486, 34-83097, IC-33077 (Apr. 24, 2018), available at <https://www.sec.gov/rules/final/2018/33-10486.pdf>.

areas that have required attention. But we are working through recommendations from our internal offices and several outside experts to improve, and we expect more recommendations to come. The review I requested by OIG, which is focused on the factors that led to the intrusion and the agency's response, similarly is ongoing. I appreciate OIG's efforts to help improve our knowledge and address risks, and I expect to receive a final report from OIG later this year. We look forward to reviewing the report and working with OIG to implement their recommendations.

We are greatly appreciative of the support given by the Committee in our efforts in this ongoing process. The additional funding Congress have given us, and the feedback that members of this Committee have given me, will go a long way to helping us upgrade our security posture to better protect against the persistent threats that continue.

Standards of Conduct for Broker-Dealers and Investment Advisers

In early 2017, as I moved through the confirmation process, it became apparent that a wide range of market participants, including retail investors, and policymakers believed that standards of conduct for investment professionals (e.g., investment advisers and broker-dealers) were a matter where Commission action, including coordination with our fellow regulators, would be both appropriate and timely. In one of my first actions as Chairman, in June 2017, I issued a request for information, seeking input from the public on a range of potential issues, and since then, I have had a number of meetings with investors, consumer groups, industry participants and others across the full spectrum of these issues.

In particular, the candid comments of retail investors in Missouri, Montana, Illinois and California, as well as those who travelled to New York for a roundtable, on what they expect and do not expect from investment professionals resonated with me in considering the appropriate course of action. These interactions, including consultations with my fellow Commissioners and staff, led me to the conclusion that the Commission should lead—but not dictate—our federal and state regulatory efforts in this area in order to (1) address investor confusion regarding the roles of, and the differences between, broker-dealers and investment advisers; (2) establish standards of conduct that meet reasonable investor expectations and adequately address conflicts of interest; and (3) minimize the effects of regulatory complexity, and potentially inconsistent legal standards applied to financial advice, due to the number of regulators in this space.²¹

In April, the Commission voted to issue for public comment a comprehensive package designed to close the gaps between the reasonable expectations of retail investors, on the one hand, and market and legal realities on the other hand.²² The package is a multi-pronged

²¹ For example, if you have a portfolio with a few stocks, a couple of mutual funds in a 401(k) and an annuity, then your relationship with your investment professional could be subject to regulation by the SEC, FINRA, the Department of Labor, state insurance regulators, state securities regulators, state attorneys general, and, if the investment professional is associated with a broker-dealer or investment adviser or both that is part of a bank, federal and/or state banking regulators.

²² See Press Release 2018-68, *SEC Proposes to Enhance Protections and Preserve Choice for Retail Investors in Their Relationships with Investment Professionals* (Apr. 18, 2018), available at <https://www.sec.gov/news/press-release/2018-68>.

solution, enhancing or clarifying obligations of broker-dealers and investment advisers to their retail clients, as well as requiring disclosure designed to increase investor understanding. Our rulemaking package would significantly enhance retail investor protection and understanding while preserving retail investor access, in terms of both availability and cost, to a variety of types of investment services, in particular, the “pay as you go” broker-dealer model.²³

First, to address conflicts of interest and establish a relationship standard that reflects reasonable retail investor expectations, we proposed enhancing the standard of conduct for broker-dealers. Under proposed Regulation Best Interest, a broker-dealer, when making a recommendation of a securities transaction or investment strategy to a retail customer, would be prohibited from placing their financial or other interest ahead of the interest of the retail customer. To add clarity for all participants, the proposal would require the broker-dealer to comply with a disclosure obligation, a care obligation and two conflict of interest obligations.

Under current standards, it has been argued that broker-dealers are permitted to recommend to their retail customer a product that is “suitable” for the customer but not as good for the customer as another product that the broker-dealer offers because the first product makes the broker-dealer more money. No reasonable retail investor thinks that makes sense. Most broker-dealers say they do not do this. I believe our regulations should prohibit this. Let me be clear: our proposed Regulation Best Interest would address this.

What would the broker-dealer have to do to act in the retail customer’s best interest? First, the broker-dealer would need to disclose material facts relating to the scope and terms of their relationship with the retail customer, including all material conflicts associated with the recommendation. Second, the broker-dealer would need to exercise reasonable diligence, care, skill and prudence to make recommendations that are in the best interest of the retail customer. Among other things, this standard would put greater emphasis on cost and financial incentives as factors in evaluating the facts and circumstances of a recommendation and whether it is in the customer’s best interest. Third, and the most significant, the broker-dealer would need to establish, maintain and enforce policies and procedures to eliminate, or mitigate and disclose, material conflicts of interest related to financial incentives. To be clear, disclosure alone would not be sufficient. Even if a broker-dealer has mitigated and disclosed its conflicts, its recommendations to the client cannot place the broker-dealer’s interests ahead of the retail customer’s interests.

The proposed broker-dealer best interest obligation draws from the principles underlying an investment adviser’s fiduciary duty, recognizing that both broker-dealers and investment advisers often provide advice in the face of conflicts of interest. These common principles are easier to compare given that as another part of our reform package we issued a proposed interpretation reaffirming—and in some cases clarifying—the fiduciary duty that investment advisers owe to their client. The interpretation is designed to provide advisers with a reference

²³ See *The Evolving Market for Retail Investment Services and Forward-Looking Regulation—Adding Clarity and Investor Protection while Ensuring Access and Choice* (May 2, 2018), available at <https://www.sec.gov/news/speech/speech-clayton-2018-05-02>.

point for understanding their obligations to clients and reaffirms that an investment adviser must act in the best interests of its client.

While the two standards draw from common principles, some obligations of broker-dealers and investment advisers will differ because the relationship types of these investment professionals differ. This is a practical necessity. But the principles are the same, and I believe the outcomes in both cases should be the same: retail investors expect high-quality advice where their investment professional is not placing their interest ahead of the investor's interest—I believe our proposals are designed to make sure they get just that.

Second, the rulemaking package would help retail investors understand who they are dealing with, what that means and why it matters. Our proposal would (1) require broker-dealers and investment advisers to clearly state what they are; and (2) prohibit stand-alone broker-dealers from using the terms “adviser” or “advisor” as part of their names or title. Also, firms would be required to provide investors with a new, distinct disclosure that we call a “Relationship Summary” that would highlight key differences between broker-dealers and investment advisers, and also provide relevant questions for investors to ask. We have already received helpful suggestions from commenters, including retail investors, on how we can improve the proposed Relationship Summary via a “feedback flyer” available on our website and look forward to even more engagement on how we get this disclosure right.

I believe that our framework will allow investment professionals to provide high-quality advice while maintaining a range of options for retail investors. More pointedly, and importantly for investors, this approach allows for further engagement with our fellow federal and state regulators to seek consistency and cohesion across the spectrum of investment professionals and products—and we intend to work closely with them to promote regulatory harmonization and reduce duplication and inconsistency.

The Commission and staff have been thinking about these issues for over 20 years and about this rulemaking for many years. I urge commenters—particularly Main Street investors—to review the proposed rules thoroughly and engage with us on it during the 90-day comment period. In order to provide as much opportunity for that engagement as possible, I also announced several investor roundtables across the country to hear directly from those the proposal is designed to serve—Main Street investors.²⁴ I, along with others at the SEC, have since met in person with retail investors in Houston and Atlanta and look forward to hearing from others at additional roundtables to come.

Digital Assets and ICOs

The digital asset and initial coin offering (ICO) markets are areas where the Commission has been focusing a significant amount of attention and resources. I am very optimistic that developments in financial technology, including distributed ledger technology, will help

²⁴ See Statement on Public Engagement Regarding Standards of Conduct for Investment Professionals Rulemaking (Apr. 24, 2018), available at <https://www.sec.gov/news/public-statement/public-engagement-standards-conduct-investment-professionals-rulemaking>.

facilitate capital formation, providing promising investment opportunities for institutional and Main Street investors alike. At the same time, regardless of the promise of this technology, those who invest their hard-earned money in opportunities that fall within the scope of the federal securities laws deserve the full protections afforded under those laws. This ever-present need comes into focus when enthusiasm for obtaining a profitable piece of a new technology “before it’s too late” is strong and broad. Fraudsters and other bad actors prey on this enthusiasm and sense of urgency.

My efforts—and the tireless efforts of the SEC staff—have been driven by various factors, but most significantly by a desire to see to it that Main Street investors understand all the material facts and risks involved, particularly with ICOs.²⁵ Unfortunately, it is clear that nefarious actors have sought to prey on investors’ excitement about the quick rise in cryptocurrency and ICO prices.²⁶

There has been significant interest and many questions about the SEC’s role in this space, particularly relating to ICOs. Some say we are slow to regulate in this area while others have requested an unprecedented relaxation of our regulations. These requests have, on occasion, been cast as a need for guidance. We have been clear—we are not relaxing our requirements that apply to the offer, sale and trading of securities. We also have discussed in detail how our laws define what is a security.²⁷ Determining what falls within the ambit of a securities offer and sale

²⁵ In December, I issued a statement that provided my general views on the cryptocurrency and ICO markets. The statement was directed principally at two groups: (1) Main Street investors and (2) market professionals—including, for example, broker-dealers, investment advisers, exchanges, lawyers and accountants—whose actions impact Main Street investors. See Statement on Cryptocurrencies and Initial Coin Offerings (Dec. 11, 2017), available at <https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11>.

²⁶ In one instance, the SEC brought an enforcement action against a purported bitcoin mining company that claimed to have a product “so easy to use that it is ‘Grandma approved.’” In this case, in less than six months, the company allegedly raised more than \$19 million from more than 10,000 investors. The SEC charged that company with operating a Ponzi scheme. See *SEC Obtains Final Judgment Against Founder of Bitcoin Mining Companies Used to Defraud Investors* (Oct. 4, 2017), available at <https://www.sec.gov/litigation/litreleases/2017/lr23960.htm>; Press Release 2015-271, *SEC Charges Bitcoin Mining Companies* (Dec. 1, 2015), available at <https://www.sec.gov/news/pressrelease/2015-271.html>.

²⁷ See Testimony on “Oversight of the SEC’s Division of Enforcement” (May 16, 2018), available at <https://www.sec.gov/news/testimony/testimony-oversight-secs-division-enforcement>; Testimony on “Oversight of the SEC’s Division of Corporation Finance” (Apr. 26, 2018), available at <https://www.sec.gov/news/testimony/testimony-oversight-secs-division-corporation-finance>; Joint Statement by Divisions of Enforcement and Trading and Markets on Potentially Unlawful Online Platforms for Trading Digital Assets (Mar. 7, 2018), available at <https://www.sec.gov/news/public-statement/enforcement-tm-statement-potentially-unlawful-online-platforms-trading>; Testimony on “Virtual Currencies: The Roles of the SEC and CFTC” (Feb. 6, 2018) available at <https://www.sec.gov/news/testimony/testimony-virtual-currencies-oversight-role-us-securities-and-exchange-commission>; Statement by SEC Chairman Jay Clayton and CFTC Chairman J. Christopher Giancarlo: Regulators Are Looking at Cryptocurrency (Jan. 25, 2018), available at <https://www.sec.gov/news/public-statement/statement-clayton-giancarlo-012518>; Joint Statement by SEC and CFTC Enforcement Directors Regarding Virtual Currency Enforcement Actions (Jan. 19, 2018), available at <https://www.sec.gov/news/public-statement/joint-statement-sec-and-cftc-enforcement-directors>; Statement on Cryptocurrencies and Initial Coin Offerings (Dec. 11, 2017), available at <https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11>; SEC Statement Urging Caution Around Celebrity Backed ICOs (Nov. 1, 2017), available at <https://www.sec.gov/news/public-statement/statement-potentially-unlawful-promotion-icos>; Statement by the Divisions of Corporation Finance and Enforcement on the Report of Investigation on The DAO (July 25, 2017), available at <https://www.sec.gov/news/public-statement/corpfm-enforcement-statement-report>.

is a facts-and-circumstances analysis, utilizing a principles-based framework that has served American companies and American investors well through periods of innovation and change for over 80 years. If you are attempting to fund a project—whether it be opening a new manufacturing plant or creating an application on a distributed network—by inviting others to invest in the enterprise based on the expectation that they will profit from other people’s efforts, the same laws and standards apply: register the securities offering or use an exemption from registration. Issuing a “token” rather than a share certificate does not change that approach. Concluding otherwise would ignore the fundamental tenets of over 80 years of securities regulation and put other businesses seeking to raise capital at a competitive disadvantage.

Overall, I believe the Commission is taking a balanced regulatory approach to distributed ledger technology (and FinTech more generally) that both fosters innovation and protects investors. For example, in the area of ICOs, the Commission issued a Report of Investigation in July 2017 regarding the application of the federal securities laws to those products.²⁸ Our Corporation Finance Division Director recently further outlined the approach staff takes to evaluate whether a digital asset is a security.²⁹ Our staff meets regularly with entrepreneurs and market professionals interested in developing new and innovative investment products in compliance with the federal securities laws. We are also encouraging issuers and other market participants to contact SEC staff at our dedicated email address, FinTech@sec.gov.

We established a dedicated Distributed Ledger Technology Working Group which focuses on emerging applications of distributed ledger technology in the financial industry, and a FinTech Working Group. We recently named a new Associate Director in Corporation Finance to serve as the Senior Advisor for Digital Assets and Innovation and coordinate efforts in this area across the agency.³⁰ We are also meeting regularly with other regulatory agencies to coordinate efforts and identify any areas where additional regulatory oversight may be needed, particularly through efforts led by the Department of the Treasury. Divisions across the Commission have worked together, as well as with other regulators, to issue public statements regarding ICOs and virtual currencies.³¹ And importantly, we have acted swiftly to crack down

investigation-dao; see also U.S. Sec. and Exch. Comm’n, *Cybersecurity Enforcement Actions*, available at <https://www.sec.gov/spotlight/cybersecurity-enforcement-actions>.

²⁸ Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO (July 25, 2017), available at <https://www.sec.gov/litigation/investreport/34-81207.pdf>.

²⁹ See William Hinman, *Digital Asset Transactions: When Howey Met Gary (Plastic)*: Remarks at the Yahoo Finance All Markets Summit: Crypto (June 14, 2018), available at <https://www.sec.gov/news/speech/speech-hinman-061418>.

³⁰ See Press Release 2018-102, *SEC Names Valerie A. Szczepanik Senior Advisor for Digital Assets and Innovation* (June 4, 2018), available at <https://www.sec.gov/news/press-release/2018-102>.

³¹ Statement by the Division of Enforcement and Office of Compliance, Inspections and Examinations on Potentially Unlawful Promotion of Initial Coin Offerings and Other Investments by Celebrities and Others (Nov. 1, 2017), available at <https://www.sec.gov/news/public-statement/statement-potentially-unlawful-promotion-icos>; Joint Statement by SEC and CFTC Enforcement Directors Regarding Virtual Currency Enforcement Actions (Jan. 19, 2018), available at <https://www.sec.gov/news/public-statement/joint-statement-sec-and-cftc-enforcement-directors>; Statement by Divisions of Enforcement and Trading and Markets on Potentially Unlawful Online Platforms for Trading Digital Assets (Mar. 7, 2018), available at <https://www.sec.gov/news/public-statement/enforcement-tm-statement-potentially-unlawful-online-platforms-trading>.

on allegedly fraudulent activity in this space, particularly fraud and other violations that have targeted Main Street investors.³²

Enforcement

Dedicated staff of the Division of Enforcement (Enforcement), led by Co-Directors Stephanie Avakian and Steven Peikin, continues its work safeguarding investors and the capital markets through the vigorous enforcement of our federal securities laws. Since I was last before the Committee, the Commission has taken a number of significant enforcement-related actions that, when considered together, demonstrate our commitment to protecting investors, deterring, detecting and punishing wrongdoing and rooting out fraud and bad actors in our financial markets. I believe that the net effect of Enforcement's efforts over the past year has been to make our capital markets a safer place for investors to put their hard-earned money to work.

After more than a year on the job, I continue to firmly believe that Enforcement's work is essential to protecting investors and maintaining confidence in the integrity and fairness of our capital markets. While some point to particular statistics to claim that the SEC and more specifically Enforcement are pulling back their investor protection efforts, I want to make absolutely clear that is not the case. As noted by Enforcement's Co-Directors in their Annual Report, our success is best judged both quantitatively and qualitatively and over various periods of time.³³ Based on such an evaluation, including bringing actions for the most serious violations, obtaining punishments to deter unlawful conduct and returning money to investors, Enforcement has been successful. I can assure you that our Enforcement Division will continue its vigorous enforcement of the federal securities laws and hold bad actors accountable.

One area where the Enforcement staff has redoubled its focus is on protecting Main Street investors. Looking out for these investors has always been a core tenet of the Commission's enforcement program, and the last year has been no exception. To bolster our capabilities and focus on protecting Main Street investors, Enforcement formed a new Retail Strategy Task Force, which concentrates resources and draws on expertise from across the Commission to develop strategies and techniques for addressing the types of misconduct that most affect retail investors.³⁴ Going forward, Enforcement will continue to place a priority on misconduct that harms retail investors, such as offering frauds, Ponzi schemes, conflicts of interest and inappropriate or excessive fees.³⁵

³² See U.S. Sec. and Exch. Comm'n, *Cybersecurity Enforcement Actions*, available at <https://www.sec.gov/spotlight/cybersecurity-enforcement-actions>.

³³ See U.S. Sec. & Exch. Comm'n, Div. of Enforcement, *Annual Report: A Look Back at Fiscal Year 2017* at 3 (Nov. 15, 2017), available at <https://www.sec.gov/files/enforcement-annual-report-2017.pdf> [hereinafter *Enforcement Annual Report*].

³⁴ See Press Release 2017-176, *SEC Announces Enforcement Initiatives to Combat Cyber-Based Threats and Protect Retail Investors* (Sept. 25, 2017), available at <https://www.sec.gov/news/press-release/2017-176>.

³⁵ For example, Enforcement's Share Class Selection Disclosure Initiative reflects our continuing commitment to protecting and compensating retail investors whenever possible. The initiative encourages self-reporting and self-remediation by investment advisers who received compensation for putting retail clients in more-expensive mutual fund share classes when identical, less-expensive share classes were available, without disclosing the conflict of interest. The initiative represents an effort by Enforcement to efficiently leverage its resources to expose widespread

Enforcement has also continued to focus its efforts on addressing cyber-related threats to investors and the financial markets. Since I was last before the Committee, these threats have only increased in magnitude and frequency, and I believe that they present some of the greatest risks that we must confront today. In response to these risks, last year Enforcement created a new Cyber Unit, which focuses the Division's resources and expertise on, among others things, hacking to obtain material, non-public information, violations involving distributed ledger technology and cyber intrusions.³⁶ The resources we have dedicated to the Cyber Unit's important work demonstrate the high priority that we continue to place on cyber-related issues affecting investors and our markets.

Returning Funds to Main Street Investors

In my view, protecting retail investors also means, whenever possible, putting money back in their pockets when they are harmed by violations of the federal securities laws. Last fiscal year, the Commission returned a record \$1.07 billion to harmed investors.³⁷ We remain committed to this important part of our work, and we expect to return a substantial amount this year as well.

The recent unanimous Supreme Court decision in *Kokesh v. SEC*, however, has impacted our ability to return funds fraudulently taken from Main Street investors. In *Kokesh*, the Supreme Court found our use of the disgorgement remedy to be a penalty, which time-limited the ability of the Commission to seek disgorgement of ill-gotten gains beyond a five-year statute of limitations applicable to penalties. I do not believe it is productive to debate the merits of the *Kokesh* decision. I agree that statutes of limitation serve many important functions in our legal system, and remedies should have reasonable limitations periods. Civil and criminal authorities, including the SEC, should do everything in their power to bring appropriate actions swiftly. But, as I look across the scope of our remedial powers, I am troubled by the substantial amount of losses that we may not be able to recover for retail investors. Said simply, if the fraud is well-concealed and stretches beyond the five-year limitations period applicable to penalties, it is likely that we will not have the ability to recover funds invested by our retail investors more than five years ago. Allowing clever fraudsters to keep their ill-gotten gains at the expense of our Main Street investors—particularly those with fewer savings and more to lose—is inconsistent with basic fairness and undermines the confidence that our capital markets are fair, efficient and provide Americans with opportunities for a better future.

I would welcome the opportunity to work with Congress to address this issue to ensure defrauded retail investors can get their investment dollars back. I believe that any such authority should be narrowly tailored to that end while being true to the principles embedded in statutes of limitations.

misconduct in the investment advisor industry while, at the same time, quickly and efficiently compensating harmed investors.

³⁶ See *SEC Announces Enforcement Initiatives to Combat Cyber-Based Threats and Protect Retail Investors*, *supra* note 34.

³⁷ Enforcement Annual Report, *supra* note 33, at 6-11.

Examination Priorities

Earlier this year, our Office of Compliance Inspections and Examinations (OCIE), led by Director Peter Driscoll, published its 2018 examination priorities with a continued focus on the SEC's commitment to protecting retail investors.³⁸ In particular, OCIE will look closely at products and services offered to retail investors, the disclosures they receive about those investments and the financial services professionals who serve them. OCIE will also focus its attention on several other areas that present heightened risks, including: (1) compliance and risks in critical market infrastructure, such as exchanges and clearing agencies; (2) the continued growth of cryptocurrencies and initial coin offerings; (3) cybersecurity; and (4) anti-money laundering programs.

OCIE conducts risk-based examinations of registered entities, including broker-dealers, investment advisers, investment companies, municipal advisors, national securities exchanges, clearing agencies, transfer agents and FINRA, among others. Our examination program is one of many areas where we have focused on doing more with our available resources. In FY 2017, OCIE completed nearly 2,900 examinations—an increase of more than 450 examinations from the prior year. As of late May, OCIE has completed more than 1,700 examinations thus far in FY 2018, representing an increase of approximately nine percent over last year at this time.

OCIE has also made significant strides to keep pace with the continued growth of investment advisers by increasing its examination of these registrants by more than 40 percent in FY 2017 over FY 2016—to approximately 15 percent of all SEC-registered investment advisers. OCIE achieved this result through the reallocation of resources, advancements in OCIE's use of technology, targeted examination initiatives and other efficiencies. Although this increase in examination coverage has been a very positive step, more needs to be done to continue to increase investment adviser examination coverage levels, while at the same time conducting high quality risk-based examinations to ensure that our mission is met. We will also continue to strive to do more with existing resources to improve our risk-based examination program.

One way to help us achieve our goals is through enhancing technological tools and continuing to use data analytics to allow our examination teams to more efficiently and effectively focus on higher risk areas and registrants. Leveraging technology helps our front line examiners analyze information better and faster than ever before. Some of our in-house developed tools scan arrays of data fields to help analyze and identify potentially problematic activities and registrants. These tools, and others employed in OCIE, have become essential to our continued advancement in identifying risks to investors and the markets, and effective deployment of examination resources to address these risks to have the greatest impact.

³⁸ U.S. Sec. & Exch. Comm'n, Off. of Compliance Inspections and Examinations, 2018 Nat'l Exam Program Examination Priorities (Feb. 7, 2018), available at <https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2018.pdf>.

Equity Market Structure

One of the few certainties of trading markets is that they continually evolve. The SEC's responsibility as the capital markets regulator is to ensure that our regulations continue to drive efficiency, integrity and resilience as technology changes.³⁹ Our Division of Trading and Markets, under the leadership of Brett Redfearn, has continued to address market structure issues.

For example, in March, the Commission proposed a transaction fee pilot in National Market System (NMS) stocks,⁴⁰ which would provide the Commission with data to help us analyze the effects of exchange fees and rebates on order routing behavior, execution quality and our market structure generally. This issue has received much attention ever since Regulation NMS was implemented, and more recently, development of a pilot program on transaction fees was one of the SEC's Equity Market Structure Advisory Committee's (EMSAC's) most prominent recommendations.⁴¹ In my view, the proposed pilot, if adopted, would lead to a more thorough understanding of these issues, which would help the Commission make more informed and effective policy decisions in the future, all to the benefit of retail investors.

Another potential issue presented by the complex U.S. equity market structure is the need for improved public transparency about alternative trading system (ATS) operations and the order-routing practices of brokers. Responding to the Commission's 2010 Concept Release on Equity Market Structure, a broad range of investors and market participants urged the SEC to address a lack of transparency in this area. The SEC published proposals to improve ATS transparency in 2015 and order routing transparency in 2016. I expect that the Commission will consider adopting final rules for the ATS initiative and the order routing initiative in the coming months. Both of these transparency initiatives highlight the traditional approach of empowering the marketplace to address problems through disclosure. Investors and market participants armed with more robust information about ATS operations and broker order routing practices should be able to make more informed decisions that reward those market participants who advance their customers' interests.

Beyond these initiatives, the Commission and staff will continue to evaluate other equity market structure issues impacting investors, issuers and other market participations. While the EMSAC's charter expired in January 2018, the staff is organizing targeted roundtables among market participants on discrete equity market structure issues, which will feature experts representative of a broad diversity of viewpoints and will provide further opportunities for discussions about critical issues affecting our equity markets. In April, the staff held its first roundtable focused on market structure issues for thinly-traded exchange-listed securities—an important issue as smaller companies, the securities of which are often relatively illiquid, play an essential role in our economy and may be the larger companies of tomorrow. Indeed, it is in

³⁹ Remarks at the Equity Market Structure Symposium Sponsored by the University of Chicago and the STA Foundation (Apr. 10, 2018), available at <https://www.sec.gov/news/speech/speech-clayton-2018-04-10>.

⁴⁰ See Press Release 2018-43, *SEC Proposes Transaction Fee Pilot for NMS Stocks* (Mar. 14, 2018), available at <https://www.sec.gov/news/press-release/2018-43>.

⁴¹ EMSAC, Recommendation for an Access Fee Pilot (July 8, 2016), available at <https://www.sec.gov/spotlight/emsac/recommendation-access-fee-pilot.pdf>.

these less active securities—where the challenges are greatest—that the potential benefits of a tailored market structure are most significant. We should continue to examine whether the current equity market structure—which is uniform for all companies, large and small, liquid and illiquid—meets the needs of all types of companies.

Fixed Income Market Structure

When I last testified before this Committee, I stated my belief that the time is right for the Commission to broaden its review of market structure to include our fixed income markets, where, historically, less attention has been focused relative to our equity markets. The fixed income markets are critical to our economy and Main Street investors. The U.S. corporate bond market has experienced significant growth since the early 2000s as issuance hit record highs and the increase in the value of corporate bonds outstanding outpaced the growth in U.S. equity market cap between 2006 and 2016.⁴² Similarly, the municipal bond market continues to be a large and vital market.

To address these issues, in November 2017, the Fixed Income Market Structure Advisory Committee (FIMSAC) was established to provide diverse perspectives on the structure and operations of the U.S. fixed income markets, as well as advice and recommendations on fixed income market structure. The FIMSAC has held two public meetings and recently provided a recommendation for a pilot program to study the market implications of changing the public dissemination regime for block-size trades in corporate bonds.

FIMSAC members have prioritized their work around key topic areas in the corporate and municipal bond markets, including the extent to which the current pre-trade and post-trade transparency regimes are serving the markets, the implications of the recent growth in the number of registered mutual funds and ETFs active in our fixed income markets and the impact of increased electronic trading systems on these markets. I am acutely aware that our interconnected and constantly evolving financial markets produce a dynamic risk landscape. As technological advancements continue to have an increasing impact on the operations of fixed income markets, the work of the FIMSAC will assist our efforts to identify emerging market developments and risks and ensure that our regulations promote efficiency, transparency and resiliency, as well as investment opportunity.

Consolidated Audit Trail

Another important market structure initiative is the implementation of the Consolidated Audit Trail (CAT). When implemented, the CAT will provide a single, comprehensive database allowing regulators to more efficiently and accurately track trading in equities and options throughout the U.S. markets. This enhanced ability will allow the Commission to better carry out its tripartite mission by improving our ability to reconstruct trading activity during a market

⁴² See Opening Remarks at the Inaugural Meeting of the Fixed Income Market Structure Advisory Committee (Jan. 11, 2018), available at <https://www.sec.gov/news/public-statement/opening-remarks-inaugural-meeting-fixed-income-market-structure-advisory>.

disruption, which in turn would allow us to more quickly understand the causes behind such disruption and respond with measures to help detect and prevent a recurrence.

Under the CAT NMS Plan, the self-regulatory organizations (SROs)—the national securities exchanges and FINRA—are responsible for developing and implementing the CAT and were required to begin reporting data to the CAT by November 15, 2017. The SROs missed that deadline, and they remain out of compliance with the CAT NMS Plan today. Progress is being made. But the process remains slow and cumbersome, due largely to what I believe are issues relating to governance and project management by the SROs. We are actively encouraging the SROs to set forth a timeline of detailed, objective and achievable milestones, clearly defined progress objectives for the SROs and Thesys (the plan processor) and a comprehensive description of the functionality that will be developed by specified dates.

I know there are substantial concerns about the protection of investors' personally identifiable information (PII) that would be stored in the CAT. I have the same concerns and continue to make the protection of CAT data, particularly any form of PII, a paramount issue. Additionally, I have made it clear that the SEC will not retrieve sensitive information from the CAT unless we need it and believe appropriate protections to safeguard it are in place.

In November, I asked the Commission staff to evaluate the need for PII in the CAT. This evaluation includes consideration of, among other things, what PII data elements need to be collected and retained in the CAT in order to achieve the regulatory goals of the CAT, and how PII in the CAT would be used by the SEC and the SROs. We are considering alternatives to the current scope of PII that would be collected and retained by the CAT under the current plan that can provide the Commission and the SROs with the market surveillance and reconstruction data needed to conduct our regulatory and enforcement functions. More generally, as I have stated before, I believe that the Commission, the SROs and the plan processor must continuously evaluate the approach to the collection, retention and protection of PII and other sensitive data, as we continue to progress in the development and operation of the CAT.

Security-Based Swaps

With respect to our security-based swap regime, the staff of the Commission continues to work to develop recommendations for final rules required by Title VII of the Dodd-Frank Act. Additionally, the staff has been actively engaged with our counterparts at the Commodity Futures Trading Commission (CFTC) to find ways to further harmonize our respective rules with those of the CFTC, where appropriate, to increase effectiveness as well as reduce complexity and costs. Staff is initially focusing on a number of different rule sets, but more generally remains committed to consulting and coordinating to the benefit of our respective agencies and the markets and market participants we oversee.

Improving the Investor Experience

We live in a world that has become rich with information and ways to present it. The Division of Investment Management (Investment Management), led by Dalia Blass, is leading a long-term project to explore modernization of the design, delivery and content of fund

disclosures and other information for the benefit of investors. These initiatives are an important part of how the Commission can serve investors in the 21st century. Fund disclosures are especially important because millions of Americans invest in funds to help them reach personal financial goals, such as saving for retirement and their children's educations. As of the end of 2017, over 100 million individuals representing nearly 60 million households, or 45 percent of U.S. households, owned funds.⁴³

Earlier this month, the Commission issued a request for comment on enhancing disclosures by mutual funds, exchange-traded funds and other types of investment companies to improve the investor experience and to help investors make more informed investment decisions (Fund Disclosure RFC).⁴⁴ The Fund Disclosure RFC seeks input from retail investors, experts and others on how they use fund disclosures and how they believe funds can improve disclosures to aid investment decision-making. In order to facilitate retail investor engagement and comment on improving fund disclosure, the Commission has provided a short Feedback Flier on Improving Fund Disclosure, which can be viewed and submitted at www.sec.gov/tell-us.

Earlier this month, the Commission also adopted a new rule that creates an optional "notice and access" method for delivering fund shareholder reports.⁴⁵ The reforms include protections for those without internet access or who simply prefer paper by preserving the ability to easily continue to receive reports in paper. Under the rule, a fund may deliver its shareholder reports by making them publicly accessible on a website, free of charge, and sending investors a paper notice of each report's availability by mail. To inform investors in advance of this new delivery method, there is an extended transition period so that the earliest a fund could begin to rely on the rule would be January 1, 2021. During this time, funds that choose to implement the new delivery method must provide prominent disclosures in prospectuses and certain other shareholder documents that will generally notify investors of the upcoming change in delivery format on a recurring basis for a period of two years.

Modernizing Asset Management Regulations

Investment Management is seeking ways to modernize and streamline rules under the Investment Company Act and Investment Advisers Act, many of which were adopted decades ago and have not been amended, notwithstanding significant changes in practices and products in the asset management industry.

Investment Management is working on a recommendation to replace the process of individually-issued exemptive relief for certain exchange-traded funds (ETFs) with a rule to create a consistent, transparent and efficient regulatory framework for ETFs and to facilitate greater competition and innovation among ETFs. This work is a high priority, as we have an ETF market of over \$3.4 trillion operating under more than 300 individually issued exemptive

⁴³ Investment Company Institute, *2018 Investment Company Fact Book*, at ii (2018), available at https://www.ici.org/pdf/2018_factbook.pdf.

⁴⁴ See Investment Company Act Release No. 33113, *Request for Comment on Fund Retail Investor Experience and Disclosure* (June 5, 2018), available at <https://www.sec.gov/rules/other/2018/33-10503.pdf>.

⁴⁵ See Securities Act Release No. 10506, *Optional Internet Availability of Investment Company Shareholder Reports* (June 5, 2018), available at <https://www.sec.gov/rules/final/2018/33-10506.pdf>.

orders.⁴⁶ It is not ideal for such an important segment of the asset management market to operate under so many individual exemptive orders.

This May, the Commission also proposed rules in furtherance of the mandate of the Fair Access to Investment Research Act of 2017.⁴⁷ These proposed rules would promote research on mutual funds, ETFs, registered closed-end funds, business development companies (BDCs) and other covered investment funds. The proposal is intended to provide investors with greater access to research to aid them in making investment decisions and would reduce obstacles to providing research on investment funds by harmonizing the treatment of such research with research on other public entities.

In 2016, the Commission adopted a new rule designed to promote effective liquidity risk management practices among open-end funds. As with any new rule, the staff's work did not end with adoption. After hearing from interested parties about the implementation of this requirement, in 2018, the Commission provided a delay for the classification elements of the rule and proposed targeted amendments to the aggregate public reporting requirements.⁴⁸ These amendments are designed to enhance the disclosure funds provide to investors about liquidity risks and reduce the risk that investors may be misled about the comparability of certain fund liquidity metrics. I anticipate that the Commission will soon consider adopting this proposal.

Additionally, the Small Business Credit Availability Act directs the Commission to revise certain securities offering and proxy rules in order to harmonize existing registration and reporting requirements to allow BDCs to be treated in the same manner as public corporate issuers. The Economic Growth, Regulatory Relief, and Consumer Protection Act similarly directs the Commission to issue rules to allow certain registered closed-end funds to use the securities offering and proxy rules that are available to public corporate issuers. Investment Management is working to develop rule recommendations related to these two bills.

Dodd-Frank Act

Almost eight years after the enactment of the Dodd-Frank Act, the Commission still has outstanding mandates. Earlier this year, I addressed how I plan to prioritize and tackle the remaining mandates from the Dodd-Frank Act.⁴⁹ Generally speaking, there are four categories of Dodd-Frank Act rules remaining:

- (1) the remaining rules to stand-up the security-based swap regime, which I believe should be done holistically as a coherent package due in large part to the interrelated nature of the rules;

⁴⁶ This market figure is based on data obtained from Bloomberg; *see also* Investment Company Act Notices and Orders, Category Listing, available at <https://www.sec.gov/rules/icreleases.shtml>.

⁴⁷ *See* Press Release 2018-92, *SEC Proposes FAIR Act Rules to Promote Research Reports on Investment Funds* (May 23, 2018), available at <https://www.sec.gov/news/press-release/2018-92>.

⁴⁸ *See* Press Release 2018-42, *SEC Proposes Targeted Changes to Public Liquidity Risk Management Disclosure* (Mar. 14, 2018), available at <https://www.sec.gov/news/press-release/2018-42>.

⁴⁹ *See* Opening Remarks at the Securities Regulation Institute (Jan. 22, 2018), available at <https://www.sec.gov/news/speech/speech-clayton-012218>.

- (2) executive compensation rules for both public companies and SEC-regulated entities, for which, as a result of the complexity and scope of the existing executive compensation disclosure regime, as well as the nature of the mandates, I believe a serial approach is likely to be most efficient and best serve the SEC's mission;
- (3) specialized disclosure rules, such as resource extraction disclosure, which pose additional challenges, including how the SEC can meet its obligations under the Administrative Procedure Act and, in the case of resource extraction, the Congressional Review Act; and
- (4) mandates, some of which overlap with examples above, for which market developments—including developments resulting from shareholder engagement—have, at least in part, mitigated some of the concerns that motivated the statutory requirements.⁵⁰ Our rulemaking priorities, as well as the rules themselves, should reflect these observable developments.

All that said, it is the SEC's obligation to complete the rules mandated by Congress in Dodd-Frank, and I intend to do so.

Investor Education and Outreach

Beyond our rulemaking agenda, we are very focused on efforts to educate Main Street investors to help empower them to make informed investment decisions – so that they have the best chance of protecting and growing their life's savings. We place great importance on in-person outreach efforts, including regional roundtable meetings with investors and events specifically targeting seniors. We also have a website at Investor.gov with a great deal of information geared specifically toward older Americans. And of course, our investor advocacy team at the SEC is just a phone call away for those Americans that don't have access to the Internet.

My fellow Commissioners and I also participate in investor education and outreach efforts with military servicewomen and men, seniors and other retail investors. Last week, all five of us, along with staff from across the agency, were in Atlanta for an investor town hall where Main Street investors heard directly from, and shared feedback with, the Commission on issues important to them.⁵¹

Earlier this year, we launched a new online search tool designed to empower retail investors to make better-informed investment decisions, the SEC Action Lookup for Individuals—or SALI.⁵² SALI enables anyone to find out if the individual he or she is dealing

⁵⁰ For example, several companies already have made public their policies regarding compensation clawbacks. Some of these policies go beyond what would be required under Dodd-Frank. We have seen a few companies attempt to claw back compensation from their executives under these policies.

⁵¹ See *Investing in America: The SEC Comes to You*, available at <https://www.sec.gov/investing-america>.

⁵² See Press Release 2018-78, *SEC Launches Additional Investor Protection Search Tool* (May 2, 2018), available at <https://www.sec.gov/news/press-release/2018-78>.

with on an investment has been sanctioned as a result of SEC enforcement actions, for both registered and unregistered individuals. It is part of our ongoing efforts to help investors research financial professionals who they are entrusting with their savings. SALI continues to be updated on an ongoing basis, making it an ever better resource for Main Street investors.

Conclusion

I would like to thank this Committee and its members, especially the Chairman and Ranking Member, for their continued support of the SEC, its mission and its staff. And most important, I thank you all for supporting our efforts to ensure that America's capital markets continue to provide quality, long-term investment opportunities that will enhance the lives and futures of our long term Main Street investors.

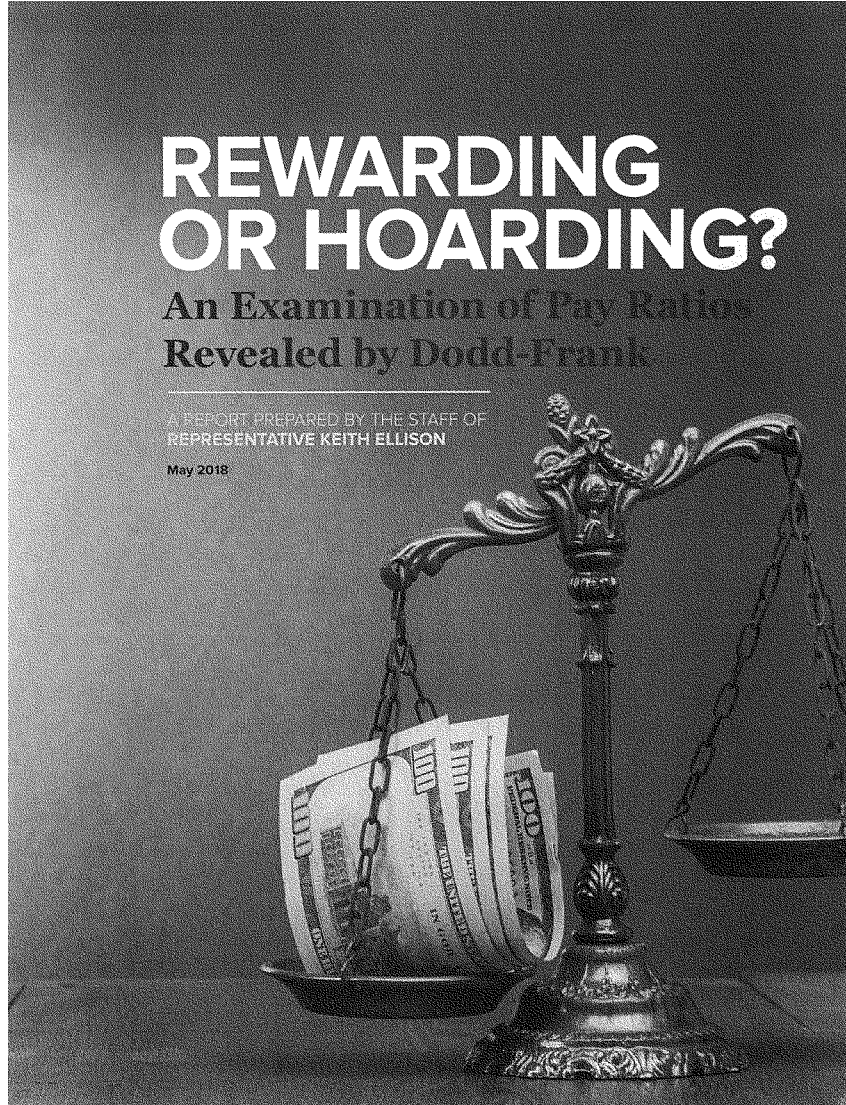
I look forward to answering any questions you may have.

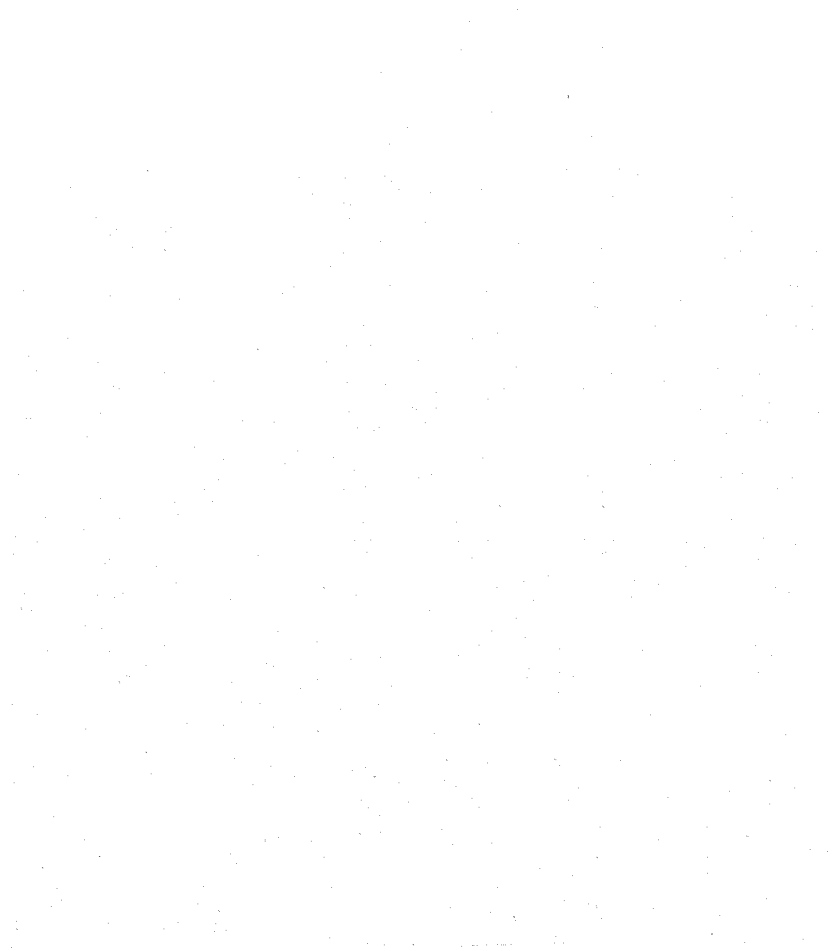
REWARDING OR HOARDING?

**An Examination of Pay Ratios
Revealed by Dodd-Frank**

A REPORT PREPARED BY THE STAFF OF
REPRESENTATIVE KEITH ELLISON

May 2018





Executive Summary

If your boss made your annual salary in less than a single day, how would you feel? Demoralized? Disgusted? Many Americans are now learning how pay is shared (or not).

For the first time in history, U.S. publicly held corporations are now required to report how much their CEO makes in comparison to the median salary of the other workers at the company. This new data source is the result of a hard-fought regulation mandated by Congress in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

The CEO-worker pay ratio is a dramatic indicator of our country's extreme economic divide. Beginning in the late 1970s, income inequality in the United States began to spiral upwards. However, this inequality was not driven by falling wages at the bottom of the income distribution. In fact, incomes for most Americans have been stagnant for four decades. Instead, this increase in income inequality was almost entirely driven by soaring compensation levels for the top 1% of income earners. Because about two-thirds of the top 1% of American households are headed by corporate executives, examining CEO pay is one key to understanding the takeoff in income inequality in the United States.

Top income earners increasingly earn their income at the expense of everyone else. In the 1970s, the top 1% of families earned less than 10% of the total national income earned by all workers; today, their share is greater than 20%. Despite increases in worker productivity over the course of the last four decades, workers are simply not earning a larger share of the output they produce.¹



CEO pay in the United States is also far out of line with CEO pay in other countries. According to a new Bloomberg analysis of twenty-two major countries, the United States' average gap between CEO and worker pay far outpaces that of other industrialized nations. The average U.S. CEO makes more than four times the average pay of a CEO abroad.²

To better understand how pay rates for CEOs of the largest companies in America compare to the salaries of workers in the middle of the pay scale, Representative Ellison requested that his staff compile and analyze the ratios of the first 225 Fortune 500 companies to publicly disclose this information. These 225 companies combined employ more than 14 million workers and generate at least \$6.3 trillion in revenue, which is more than a 25% of 2017's fourth quarter GDP.³ This report finds:



Pay ratios of Fortune 500 companies range from 2:1 at the low end to nearly 5,000:1 at the high end. The average CEO to median worker pay ratio among all 225 companies is 339:1. For historical context, in 1965, the average CEO made 20 times the average worker.⁴



In 188 of the 225 companies in our database a single CEO's pay could be used to pay more than 100 workers. A company's ratio can also be read as the number of "median" workers who could be hired for the amount their CEO makes annually. At McDonalds, for example, the CEO's annual salary could be used to pay the yearly wages of 3,101 workers making the median pay.⁵



Median employees in all but six companies in our database would need to work at least one 45-year career to earn what their CEO makes in a single year. For example, it would take the median employee at PepsiCo who works for a full 45-year career (age 18 to 63) more than 14 full careers (650 years) to make what their CEO makes annually (650/45=14.4).



The industry with the highest average ratio of CEO to worker pay is the consumer discretionary industry with a ratio of 977:1. This category includes companies that sell clothing and food such as McDonalds, Gap, and Kohl's.

Introduction

In response to the 2008 financial crisis that crashed the global economy and destroyed trillions of dollars of Americans' retirement and housing wealth, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) of 2010. This comprehensive legislation put safeguards in place to ensure that Wall Street banks were no longer placing reckless bets that put our financial markets at risk. One of Congress's concerns related to the financial crash was that performance-based pay schemes for CEOs actually incentivized risk-taking and put consumers and investors at risk. To better understand corporate pay practices, Congress included a provision in Dodd-Frank that required publicly traded companies to report their CEO to median worker pay ratio.⁶ Many institutional investors strongly supported this transparency reform, arguing that extreme pay gaps undermine enterprise effectiveness by lowering employee morale and productivity.

However, due to a sluggish rulemaking process at the Securities and Exchange Commission (SEC), the rule was put off for years. In 2015, five years after Dodd-Frank was signed into law, Democratic lawmakers, including Representative Ellison,^{7,8} increased their demands for action, sending multiple letters to SEC Chair Mary Jo White expressing their disappointment in the agency's slow rulemaking process.⁹ That same year, the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) filed a Freedom of Information Act (FOIA) request for all records regarding the SEC's decision to release its final rule.¹⁰

In August 2015, after sustained pressure from a wide range of advocates, including state treasurers and other institutional investors, labor unions, and lawmakers across the country, the SEC voted to finalize the pay ratio disclosure rule in a 3-2 decision, with all three Democratic SEC Commissioners voting in support of the rule and both Republican SEC commissioners voting in opposition.¹¹

The Trump administration, Republicans in Congress, and the private sector have all attempted to kill this rule over the past year.¹² In February of 2017, merely one month after President Trump was sworn-in, the SEC re-opened public comment for the rule and encouraged companies to weigh in with complaints about difficulties in calculating the pay ratio.¹³ The agency instead was flooded with letters in support of the rule.¹⁴ By one count, they received over 14,000 letters in favor of the CEO pay rule and only 30 in opposition.¹⁵

Later that February, the Business Roundtable, a CEO-led lobby group, sent a letter to the Trump administration in support of repealing the CEO pay ratio rule.¹⁶ The Business Roundtable's Chair is JPMorgan Chase CEO Jamie Dimon, who we now know made 364 times his median employee's salary in 2017.¹⁷ Following the Business Roundtable

letter, the Treasury Department recommended that the SEC repeal the rule.¹⁸ In March 2017, the Financial Services Roundtable, under then-President and CEO Tim Pawlenty, sent a letter to the SEC in support of further delaying the rule one year, to “allow time for Congress to review and repeal the mandate for the Pay Ratio Rule.”¹⁹

Despite powerful attempts to kill this rule, popular will prevailed. The first CEO-median worker pay ratio disclosures have been submitted to the SEC. This report is the first comprehensive analysis of CEO pay ratios of large, publicly traded companies.



Methodology

Calculating CEO Compensation

The SEC's rule requires that a CEO's compensation be identified in the Principal Executive Officer (PEO)'s "Total Compensation" column of a company's publicly-available Summary Compensation Table (SCT) for the last completed fiscal year in a company's annual proxy statement (DEF 14A).²⁰ The terms "PEO" and "CEO" are used interchangeably here.²¹ This column includes salary, bonus, stock awards, option awards, non-equity incentive plan compensation, and change in pension value and nonqualified deferred compensation earnings. If a company has two or more subsequent PEOs in a single year, the company may add the multiple PEOs' compensation together.²² Alternatively, a company may annualize one of their PEO's salaries.²³ For example, if a PEO worked at a company for six months and made \$1,000,000 a company could report the PEO's annualized compensation as \$2,000,000.²⁴

For consistency's sake, calculating the annual total compensation of a PEO for the purpose of determining the pay ratio must "reflect the same approach"²⁵ used to determine the median employee's salary. The same approach only needs to be applied to the median employee, not all employees at the company.

Calculating Median Employee Compensation

The final pay ratio rule itself, and the SEC-issued interpretive guidance on the rule,²⁶ allow for companies to calculate median employee salary using a number of different methods, including by using a statistical sample of the company's workforce. To determine its CEO-median employee pay ratio, a company must identify a single employee whose compensation is at the midpoint of all employees in the sample who are not the company's CEO.²⁷

Although companies are required to report their ratios annually, a company can determine its median employee's compensation once every three years if it "reasonably believes"²⁸ that there has been no change in the company's employee population, and if the company's employee compensation arrangements have not changed significantly from the previous year. An "employee" is defined as a person employed at any date of the company's choosing in the last three months of the company's last completed fiscal year.²⁹ A company must identify the date used to determine its median employee.³⁰ Part-time, temporary, seasonal, and full-time employees are required to be counted.³¹ Annualization is only permitted for full-time employees who have not worked the full fiscal year.³²

Industry groups, particularly the National Retail Federation, pushed hard, and continue to push³³ the SEC to allow companies to fully exclude part-time and seasonal workers in the calculation of median worker pay or allow firms to make their pay appear higher than it actually is by converting these precarious jobs into full-time equivalents. The

SEC refused,³⁴ arguing that including actual pay figures “is more reflective of the actual composition of the registrant’s workforce and thus furthers the purpose of providing shareholders with useful information about a registrant’s overall compensation practices.”

A company’s median employee can be identified by using “reasonable estimates.”³⁵ Companies are required to apply the same compensation measure across all employees. If a company identifies characteristics in their median employee’s salary that would skew their pay ratio, like a large one-time bonus, the company “may substitute another employee with substantially similar compensation to the original identified median employee based on the compensation measure it used to select the median employee.”³⁶ In identifying the median employee, companies may also make cost of living adjustments (COLA) to employee compensation when the employees live in a jurisdiction other than the one where the CEO resides.³⁷

Although the rule requires both U.S. and non-U.S. employees to be counted, it allows a company to exempt non-U.S. employees where they make up five percent or less of the total number of employees.³⁸ If a company’s total number of non-U.S. employees exceeds five percent of its total employees, that company may exclude up to five percent of its total non-U.S. employees. If a company excludes any non-U.S. employees, it needs to disclose the number of employees being excluded from each jurisdiction, and which jurisdictions are excluded.³⁹ Additionally, it must disclose the total number of U.S. and non-U.S. employees working for it, regardless of any exemption. So, in order to exempt non-U.S. workers from its pay ratio reporting, a company must disclose additional data regarding their overseas employees, enhancing the transparency benefits of the regulation.⁴⁰

Companies may present supplemental ratios and information in addition to the required ratio if they wish to do so, such as in cases where a large percentage of overseas employees creates a significantly different ratio. However, this is not required. If a



company presents additional ratios or supplemental information, it must be identified as such, and cannot be misleading or more prominently displayed than the required ratio.⁴¹

Third-party contractors and leased workers may be excluded if they are employees of companies that are not “consolidated subsidiaries.”⁴² If the reporting company owns less than 50% of outstanding voting shares of the third-party company, its contractors or leased employees may generally be excluded.⁴³ According to the SEC, excluding these workers is appropriate because their pay is determined outside the company itself.⁴⁴

Compiling the Data

These data were compiled by Bloomberg from the SEC’s EDGAR database.⁴⁵ We have limited our data to the first 225 Fortune 500 companies to file with the SEC. Bloomberg’s reported ratios are rounded to the nearest integer. For example, Bloomberg has reported Berkshire-Hathaway’s CEO pay ratio as “2,”⁴⁶ while the calculated ratio is “1.87.”⁴⁷ To check for discrepancies, we have included a “calculated ratio” tab in our full database online, using the calculated ratio of median employee salary and CEO pay as reported by Bloomberg.

In some cases, a company’s ratio as reported by Bloomberg and our “calculated ratio” differ. This could be due to a company changing the CEO’s pay from the SCT to be consistent with the measures used to calculate their median employee salary. They could also be due to rounding or reporting error by Bloomberg. The companies that fall into this category in our database are W.W. Grainger, Alaska Air, American Financial Group, Abbott Laboratories, and Archer Daniels Midland.

The “employee population” column is compiled from companies’ 10k filings. The total employee population that is used by companies in their proxy statements to calculate CEO to median employee pay ratio may differ. For instance, ManpowerGroup uses an employee pool that is substantially larger than the number of full-time employees reported in its 10k⁴⁸ filing to calculate its median employee to CEO pay ratio.

Companies Exempted from the Rule

According to the SEC, approximately 3,571 companies are required to file ratio disclosures.⁴⁹ Small reporting companies and companies defined as “emerging growth” under the Jumpstart Our Business Startups Act (JOBS Act) [15 U.S.C. 78c(a)] are exempted from filing a pay ratio disclosure.⁵⁰ To meet the “emerging growth” threshold, the company (“issuer”) needs to have had total annual gross revenues of less than \$1 billion in its most recently completed fiscal year. Snap Chat, for example, is considered an emerging growth company and therefore did not have to report a CEO-worker pay ratio this year, despite the fact that the firm’s CEO, Evan Spiegel, made \$638 million.⁵¹ Companies based overseas are not required to file a pay ratio disclosure.

CEOS AND FIRMS RESPOND TO PAY RATIO DISCLOSURES:

“Comparing what I do to the median employee is not even apples and oranges. It’s more like fruit compared to Star Wars. They don’t know how to allocate capital, and their educational level and skill set is vastly different...People have decisions to make as to whether they want to improve themselves and get higher paying jobs. Some people decide to do that and others don’t.”

RONALD L. HAVNER, CEO, PUBLIC STORAGE⁸²



“[The pay ratio rule] is a cooked-up thing to embarrass firms with a lot of part-time workers.”

ALAN JOHNSON, MANAGING DIRECTOR OF THE PAY CONSULTING FIRM JOHNSON ASSOCIATES⁸³

“McDonald’s is committed to a strong pay for performance culture that stresses “at risk” compensation in order to closely align their interests with those of shareholders.”

MCDONALDS 14A FILING⁸⁴

⁸² CEOs and Firms Respond to Pay Ratio Disclosures

Findings



The company with the smallest ratio in our database is Warren Buffett's Berkshire Hathaway, with a ratio of 2:1. The company with the largest ratio is Mattel, a toy manufacturing company, with a ratio of 4,987:1.

The other companies in our database with ratios of over 1,000:1 are Mattel, McDonald's, Gap, Live Nation Entertainment, Yum China Holdings, ManpowerGroup, Hanesbrands, Liberty Interactive, Yum! Brands, VF, Ross Stores, Kohl's, and Walmart. The company with the highest-paid CEO is the event promoter and venue operator, Live Nation Entertainment, whose CEO made \$70,615,760 in 2017. Berkshire Hathaway's CEO, Warren Buffett, the country's third-richest man, had the lowest pay in 2017 of any CEO in our database. He made \$100,000 last year. The company with the highest-paid median worker in our database is Valero Energy, with annual earnings of \$192,837. The company with the lowest-paid median worker is Yum China Holdings, whose median employee makes only \$3,396 per year. Their median employee's salary is so low because nearly all of their workers are in China, where worker pay is significantly lower than the United States. Additionally, roughly 60% of their 420,000 crewmembers are part-time and hourly workers.⁵²

Companies with Top 25 CEO to median worker pay ratios

Company Name	CEO Pay	Median Worker Pay	Reported Ratio (:1)	Employees	Industry
Mattel	\$31,275,289	\$6,271	4,987	28,000	Consumer Discretionary
McDonald's	\$21,761,052	\$7,017	3,101	235,000	Consumer Discretionary
Gap	\$15,587,186	\$5,375	2,900	135,000	Consumer Discretionary
Live Nation Entertainment	\$70,615,760	\$24,406	2,893	8,800	Consumer Discretionary
Yum China Holdings	\$9,571,017	\$3,396	2,818	450,000	Consumer Discretionary
ManpowerGroup	\$11,987,783	\$4,828	2,483	29,000	Industrials
Hanesbrands	\$9,581,985	\$5,237	1,830	67,200	Consumer Discretionary
Liberty Interactive	\$47,809,756	\$26,407	1,810	N/A	Consumer Discretionary
Yum Brands	\$12,368,607	\$9,111	1,358	60,000	Consumer Discretionary
VF	\$13,736,655	\$10,151	1,353	69,000	Consumer Discretionary
Ross Stores	\$12,400,574	\$9,437	1,314	82,700	Consumer Discretionary
Kohl's	\$11,339,206	\$8,976	1,264	33,000	Consumer Discretionary

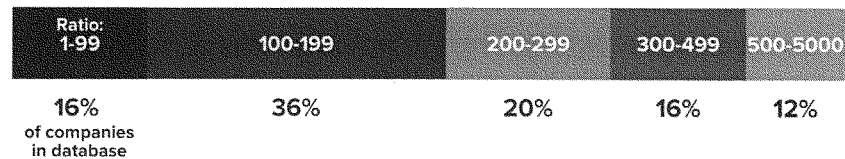
Company Name	CEO Pay	Median Worker Pay	Reported Ratio (:1)	Employees	Industry
Walmart	\$22,791,276	\$19,177	1,188	2,300,000	Consumer Staples
Marathon Petroleum	\$19,670,807	\$21,034	935	43,800	Energy
Burlington Stores	\$8,901,891	\$11,662	763	40,000	Consumer Discretionary
Foot Locker	\$6,402,450	\$8,554	748	15,141	Consumer Discretionary
Avery Dennison	\$8,959,468	\$12,016	746	30,000	Materials
AIG	\$44,738,581	\$64,186	697	49,800	Financials
Amphenol	\$8,165,544	\$12,179	670	70,000	Technology
Dollar General	\$8,806,409	\$13,387	658	129,000	Consumer Discretionary
Fidelity National Information Services	\$29,141,610	\$44,556	654	53,000	Technology
PepsiCo	\$31,082,648	\$47,801	650	263,000	Consumer Staples
Omnicom Group	\$23,959,325	\$40,230	596	77,300	Consumer Discretionary
CBS	\$69,351,540	\$116,654	595	12,700	Consumer Discretionary
Universal Health Services	\$21,630,861	\$39,978	541	76600	Healthcare
Robert Half International	\$8,799,147	\$17,340	507	17,200	Industrials
Leucadia National	\$21,787,285	\$44,584	489	12,700	Financials
Newell Brands	\$15,257,808	\$32,010	477	49,000	Consumer Discretionary
Lowe's	\$11,208,658	\$23,905	469	310,000	Consumer Discretionary
Johnson & Johnson	\$29,802,564	\$66,000	452	134,000	Healthcare
L Brands	\$5,695,577	\$12,673	449	25200	Consumer Discretionary
S&P Global	\$10,719,216	\$24,714	434	20,000	Financials
Illinois Tool Works	\$17,109,870	\$40,738	420	50,000	Industrials
Mondelez International	\$17,304,919	\$42,893	403	83,000	Consumer Staples
Wyndham Worldwide	\$15,094,362	\$37,934	398	39,200	Consumer Discretionary



A company's CEO-to-median employee pay ratio can also be interpreted as the number of median employees a company can pay with their CEO's salary. At the vast majority of companies in our database, you could pay 100 median employees or more with a CEO's annual pay.

At over one-third of the companies in our database, you could pay between 100-199 median employees with a single CEO's pay. A little less than half the CEOs in our database are paid in one year the amount it would take to employ between 200 and 4,987 median employees.

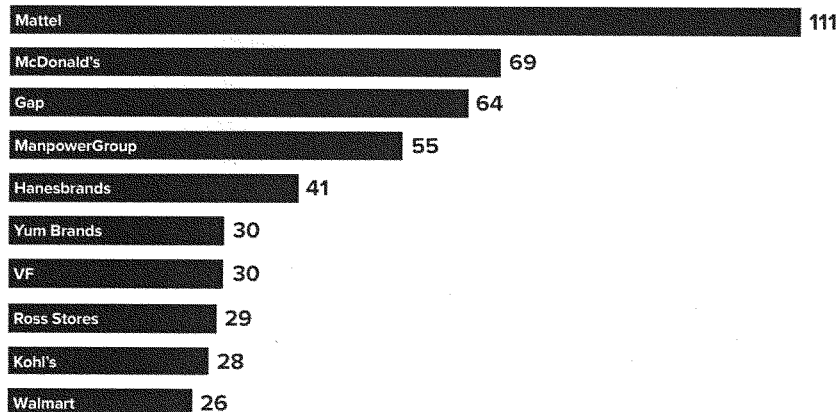
How many median employees could one CEO's salary employ?



In all but six companies in our database, it would take the median employee more than one full career to make what their CEO makes in a single year.

For this calculation, we assume that a full career is 45 years of work (ages 18-63). At CVS Health, for example, the median worker would need to be on the job for 319 years, or more than seven full careers, to make their CEO's annual salary. Old Republic International, Berkshire Hathaway, Host Hotels and Resorts, salesforce.com, XPO Logistics, and CMS Energy are the only six companies with CEOs who make less than a single career's worth of work for their median employee.

How many careers would a median employee need to work to earn a CEO's annual salary?



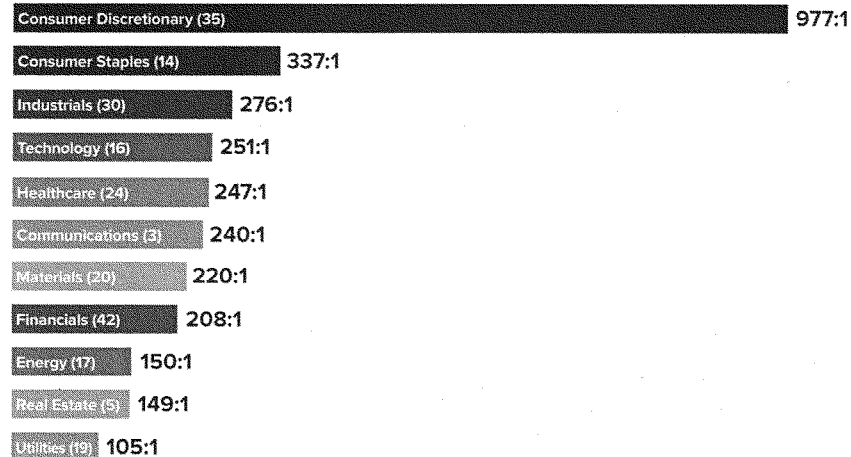


Pay ratios vary by industry sector. The sector with the highest average CEO to median worker pay ratio is Consumer Discretionary, which includes companies like McDonald's, Gap, and Mattel.

According to the financial services firm Vanguard, "Consumer Discretionary" is defined as "companies that manufacture products and provide services that consumers purchase on a discretionary basis."⁵⁵ The sector with the lowest ratio is Utilities, which includes companies like CenterPoint Energy and Exelon. Vanguard defines utilities as "companies that distribute electricity, water, or gas, or that operate as independent power producers."⁵⁶ It is possible that since the Consumer Discretionary industry employs so many part-time workers, their ratios are the highest. It is also possible that in the Energy, Real Estate and Utilities industries, the sectors with the smallest ratios, the tendency to hire more third-party contractors allows companies to report an artificially low ratio, since the pay ratio rule allows for the exclusion of such workers.

For example, Newmont Mining, which reported the relatively low ratio of 114:1, states on its website that the company "has 30,000 employees and contractors."⁵⁷ However, when reporting its pay ratio, the company is allowed to state that it only has 'approximately 12,500 employees.'⁵⁸ Host Hotels & Resorts only reports having 205 employees, despite owning 93 hotels, with roughly 52,000 rooms in total.⁵⁹ If companies were required to report third-party contractors, the average ratio between CEO and median employee could be much higher.

What is the average CEO to median worker pay ratio by industry sector?

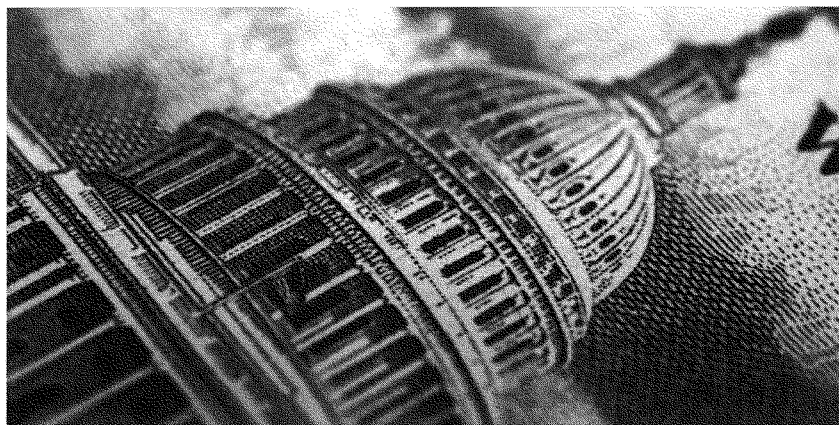


Policy Solutions

Academics and policymakers have come up with a number of ideas that could help curtail skyrocketing CEO pay and make our nation more equal. The most recent example comes from Portland, Oregon, where in 2016 the city council created a tax penalty for publicly traded companies with pay gaps higher than 100:1. The tax penalty increases proportionately for pay gaps higher than 100:1. This new ordinance went into effect this year. Several other city and state governments are looking at similar legislation.⁶⁰

Other policymakers, including state legislators in Rhode Island, are considering an approach that would give companies with low CEO to worker pay ratios preferential treatment when bidding for government contracts. The President has broad discretion to set policies for federal contractors. During President Obama's tenure his administration began requiring government contractors to pay a minimum wage of \$10.10 (the federal minimum wage is only \$7.25). The federal government also denies contracts to companies that contribute to racial and gender inequality through discrimination in their hiring and employment practices. Federal corporate subsidy policies could also be reformed to encourage companies to narrow their gaps.

Another policy option includes increasing taxes on top incomes. Prior to the Reagan administration, top marginal tax rates were more than 70%, and, not surprisingly, executive compensation levels were substantially lower. CEOs had no incentive to demand sky-high pay, since much of it would be taxed away anyway. Some economists have suggested that the optimal tax marginal rate for U.S. incomes today would be about 83%.⁶¹ Unfortunately, the recently passed Tax Cuts and Jobs Act of 2017 moves in the opposite direction, lowering the current top tax rate of 39.6% to 37% for tax years beginning in 2018.



Conclusion

Before these data were published, we knew that on average, the CEO-worker pay gap had grown since the 1970s, and that the gap between CEO and median worker pay was severe. These new data give us a much clearer picture as to which corporations are sharing the wealth and which are not. Astoundingly, they tell us that that some Chief Executives make up to thousands of times what over half their employees make and that pay ratios are particularly large in the consumer discretionary industry. Additionally, the ability for companies to exclude third-party contractors, which sometimes count for over half of a company's workforce, suggests that the true level of inequality between CEO pay and median worker pay is even higher than we observe in this report. This report demonstrates an urgent need for lawmakers to enact policies to address the historically severe gap between CEO and worker pay.



Appendix 1

Full database

Company Name	CEO Pay	Median Worker Pay	Reported Ratio (:1)	Employees
Mattel	\$31,275,289	\$6,271	4,987	28,000
McDonald's	\$21,761,052	\$7,017	3,101	235,000
Gap	\$15,587,186	\$5,375	2,900	135,000
Live Nation Entertainment	\$70,615,760	\$24,406	2,893	8,800
Yum China Holdings	\$9,571,017	\$3,396	2,818	450,000
ManpowerGroup	\$11,987,783	\$4,828	2,483	29,000
Hanesbrands	\$9,581,985	\$5,237	1,830	67,200
Liberty Interactive	\$47,809,756	\$26,407	1,810	N/A
Yum Brands	\$12,368,607	\$9,111	1,358	60,000
VF	\$13,736,655	\$10,151	1,353	69,000
Ross Stores	\$12,400,574	\$9,437	1,314	82,700
Kohl's	\$11,339,206	\$8,976	1,264	33,000
Walmart	\$22,791,276	\$19,177	1,188	2,300,000
Marathon Petroleum	\$19,670,807	\$21,034	935	43,800
Burlington Stores	\$8,901,891	\$11,662	763	40,000
Foot Locker	\$6,402,450	\$8,554	748	15,141
Avery Dennison	\$8,959,468	\$12,016	746	30,000
AIG	\$44,738,581	\$64,186	697	49,800
Amphenol	\$8,165,544	\$12,179	670	70,000
Dollar General	\$8,806,409	\$13,387	658	129,000
Fidelity National Information Services	\$29,141,610	\$44,556	654	53,000
PepsiCo	\$31,082,648	\$47,801	650	263,000
Omnicom Group	\$23,959,325	\$40,230	596	77,300
CBS	\$69,351,540	\$116,654	595	12,700
Universal Health Services	\$21,630,861	\$39,978	541	76,600
Robert Half International	\$8,799,147	\$17,340	507	17,200
Leucadia National	\$21,787,285	\$44,584	489	12,700
Newell Brands	\$15,257,808	\$32,010	477	49,000
Lowe's	\$11,208,658	\$23,905	469	310,000
Johnson & Johnson	\$29,802,564	\$66,000	452	134,000
L Brands	\$5,695,577	\$12,673	449	25,200
S&P Global	\$10,719,216	\$24,714	434	20,000
Illinois Tool Works	\$17,109,870	\$40,738	420	50,000
Mondelez International	\$17,304,919	\$42,893	403	83,000
Wyndham Worldwide	\$15,094,362	\$37,934	398	39,200

Company Name	CEO Pay	Median Worker Pay	Reported Ratio (:1)	Employees
MGM Resorts International	\$14,579,720	\$36,785	396	51,000
Cognizant Technology Solutions	\$12,478,392	\$31,998	390	260,000
PPG Industries	\$14,249,861	\$37,307	382	47,200
Centene	\$25,269,468	\$66,600	379	33,700
Hershey	\$10,600,386	\$28,173	376	15,360
Citigroup	\$17,814,131	\$48,249	369	209,000
AT&T	\$28,720,720	\$78,437	366	254,000
J.P. Morgan Chase	\$28,320,175	\$77,799	364	252,539
Stanley Black & Decker	\$16,236,936	\$45,449	357	57,765
Whirlpool	\$7,082,024	\$19,906	356	92,000
Corning	\$16,868,575	\$47,410	356	46,200
Baxter International	\$14,933,664	\$42,008	355	47,000
Bank of New York Mellon Corp.	\$19,837,535	\$55,970	354	52,500
Humana	\$19,768,525	\$57,385	344	47,900
Murphy USA	\$5,777,908	\$16,831	343	5,400
Honeywell International	\$16,753,438	\$50,296	333	131,000
Kimberly-Clark	\$16,209,534	\$48,866	332	42,000
Advance Auto Parts	\$6,127,997	\$18,460	329	40,000
American Express	\$18,611,373	\$56,873	327	55,000
Thermo Fisher Scientific	\$22,275,176	\$68,732	324	70,000
3M	\$20,494,285	\$63,338	324	91,536
Sherwin-Williams	\$13,513,194	\$41,827	323	52,695
CVS Health	\$12,266,076	\$38,372	320	160,000
Crown Holdings	\$11,939,960	\$37,800	316	24,000
Pfizer	\$27,913,775	\$89,206	313	90,200
Aflac	\$22,830,984	\$76,089	300	11,318
UnitedHealth Group	\$17,404,604	\$58,378	298	260,000
Western Union	\$9,726,400	\$33,278	292	11,500
Wells Fargo	\$17,564,014	\$60,446	291	262,700
Laboratory Corp. of America	\$11,646,254	\$41,609	280	60,000
Cigna	\$17,595,792	\$63,010	279	46,000
Tractor Supply	\$6,701,831	\$24,108	278	14,000
Freeport-McMoRan	\$18,396,037	\$66,490	277	25,200
Archer Daniels Midland	\$15,875,055	\$57,345	276	31,300
Cummins	\$16,387,661	\$59,682	275	58,600
PayPal Holdings	\$19,218,634	\$70,228	274	18,700
UPS	\$14,619,684	\$53,443	274	454,000
AutoNation	\$12,186,944	\$45,543	268	26,000
Prudential Financial	\$27,120,220	\$101,067	268	49,705
Interpublic Group	\$16,883,818	\$63,936	264	50,200
Anthem	\$18,578,802	\$70,867	262	56,000

Company Name	CEO Pay	Median Worker Pay	Reported Ratio (:1)	Employees
Capital One Financial	\$16,175,770	\$62,037	261	49,300
American Tower	\$13,119,417	\$50,384	260	4,752
Abbott Laboratories	\$16,784,892	\$75,679	251	99,000
Bank of America Corp.	\$21,791,812	\$87,115	250	209,376
Univar	\$15,245,285	\$60,904	250	8600
BorgWarner	\$14,085,523	\$57,127	247	29,000
Ecolab	\$14,383,229	\$60,556	238	48,400
Dover	\$9,952,918	\$41,943	237	29,000
State Street Corp.	\$19,497,361	\$82,760	236	36,643
Aetna	\$18,750,816	\$79,720	235	47,950
United Technologies	\$17,027,493	\$72,433	235	205,000
Huntsman	\$16,816,057	\$72,506	232	10,000
International Paper	\$19,446,293	\$84,701	230	56000
Coca-Cola	\$10,874,694	\$47,312	230	61,800
Ameriprise Financial	\$23,914,109	\$107,082	223	13,000
Assurant	\$9,274,743	\$41,853	222	14,750
Lincoln National	\$14,963,035	\$68,299	219	5,000
General Dynamics	\$21,501,429	\$98,563	218	98,600
Quest Diagnostics	\$10,368,835	\$48,194	215	45,000
Merck	\$17,643,087	\$82,173	215	69,000
NCR	\$12,435,018	\$58,506	213	34000
CenturyLink	\$14,715,560	\$69,252	212	51,000
Intel	\$21,544,700	\$102,210	211	102,700
Texas Instruments	\$16,573,019	\$78,951	210	29,714
Dr Pepper Snapple Group	\$8,921,147	\$42,689	209	21000
Stryker	\$14,005,086	\$66,901	209	33,000
Goodyear Tire & Rubber	\$10,845,759	\$52,704	206	64000
U.S. Bancorp	\$11,960,654	\$58,269	205	72,402
Regions Financial	\$12,733,913	\$63,174	202	21,714
PNC Financial Services Group	\$13,917,986	\$69,190	201	50,358
Reliance Steel & Aluminum	\$11,357,647	\$51,172	199	14,900
BlackRock	\$27,743,233	\$141,987	195	13,900
American Airlines Group	\$12,175,486	\$62,394	195	126,600
Jones Lang LaSalle	\$9,219,001	\$48,000	192	82,000
Morgan Stanley	\$24,509,722	\$127,863	192	57,633
AES	\$9,354,683	\$49,229	190	N/A
Nordstrom	\$5,634,701	\$30,105	187	72,500
Lockheed Martin	\$22,866,843	\$123,231	186	100,000
Kellogg	\$7,344,238	\$40,163	183	33,000
Chevron	\$24,781,568	\$137,849	180	51,900
Sealed Air	\$10,900,704	\$61,031	179	15,000

Company Name	CEO Pay	Median Worker Pay	Reported Ratio (:1)	Employees
Seaboard	\$5,606,959	\$32,073	175	11800
Duke Energy	\$21,415,936	\$122,365	175	29,060
Raytheon	\$24,883,871	\$144,589	172	64,000
Bristol-Myers Squibb	\$18,687,123	\$110,280	169	23,700
Penske Automotive Group	\$6,807,491	\$40,409	168	26000
Eastman Chemical	\$14,489,656	\$86,728	167	14,000
Owens Corning	\$10,293,191	\$62,069	166	17,000
United Rentals	\$12,828,962	\$77,127	166	14800
TreeHouse Foods	\$7,815,396	\$47,382	165	13,489
Goldman Sachs Group	\$21,995,266	\$135,165	163	36,600
SunTrust Banks	\$9,592,062	\$60,477	159	23,785
Ball	\$12,932,654	\$82,329	157	18,300
Celanese	\$11,919,628	\$75,928	157	7,592
General Electric	\$9,000,603	\$57,211	157	313,000
Packaging Corp. of America	\$10,658,595	\$68,888	155	14600
Unum Group	\$9,683,946	\$62,650	155	9,400
Citizens Financial Group	\$8,549,989	\$55,118	155	17,594
NextEra Energy	\$18,811,693	\$121,355	155	14,000
Travelers Cos.	\$15,244,942	\$99,004	154	30,900
Fluor	\$10,253,787	\$67,580	152	56,706
American Financial Group	\$9,772,850	\$64,339	151	6,700
Fiserv	\$10,422,743	\$69,205	151	24,000
Weyerhaeuser	\$11,447,707	\$75,893	151	9300
BB&T Corp.	\$12,692,776	\$84,550	150	36,484
Charles Schwab	\$14,348,737	\$98,152	146	17,600
WellCare Health Plans	\$11,344,738	\$78,139	145	8,900
Alliance Data Systems	\$10,882,813	\$75,232	145	20,000
Fifth Third Bancorp	\$8,688,292	\$60,078	145	18,125
AbbVie	\$22,625,243	\$157,347	144	29,000
Hartford Financial Services Group	\$13,115,285	\$91,865	143	16,400
eBay	\$17,590,833	\$122,891	143	14,100
Verizon	\$17,947,316	\$126,623	142	155,400
Spirit AeroSystems Holdings	\$9,907,398	\$70,452	141	13,700
Genuine Parts	\$4,919,486	\$35,415	139	48,000
Ryder System	\$6,137,757	\$44,344	138	36100
Phillips 66	\$23,677,209	\$170,988	138	14,600
ConocoPhillips	\$21,864,670	\$158,943	138	11,400
Sempra Energy	\$18,039,051	\$134,571	134	16,046
Netflix	\$24,377,499	\$183,304	133	5,400
Nucor	\$12,090,472	\$90,635	133	25,100
Norfolk Southern	\$11,955,417	\$91,791	130	27,110

Company Name	CEO Pay	Median Worker Pay	Reported Ratio (:1)	Employees
Alleghany	\$9,647,362	\$74,782	129	4402
Eversource Energy	\$15,915,461	\$124,959	127	8084
Exelon	\$14,857,859	\$117,176	127	34,621
Amgen	\$16,889,789	\$132,930	127	20,800
Arthur J. Gallagher	\$7,886,491	\$62,441	126	26,783
Chesapeake Energy	\$14,903,906	\$118,761	125	3,200
Alcoa	\$10,720,123	\$88,740	121	14,600
Principal Financial	\$11,985,735	\$100,355	119	14,895
KeyCorp	\$8,146,470	\$68,875	118	18,415
Eli Lilly	\$15,845,991	\$134,003	118	40,655
Valero Energy	\$22,532,260	\$192,837	117	10,015
Quanta Services	\$8,763,657	\$75,554	116	32,800
Alaska Air Group	\$5,734,862	\$49,664	116	23,156
United Continental Holdings	\$9,561,134	\$83,122	115	89,800
Voya Financial	\$10,989,072	\$95,399	115	6,300
Southern	\$15,702,228	\$138,000	114	31,344
Altria Group	\$15,719,769	\$137,763	114	8,300
Newmont Mining	\$13,827,445	\$121,008	114	12,547
WESCO International	\$6,962,755	\$61,562	113	9,000
WEC Energy Group	\$13,642,237	\$120,223	113	8,129
W.W. Grainger	\$6,966,359	\$63,577	113	24,400
Xerox	\$9,505,048	\$85,276	111	35,300
Occidental Petroleum	\$12,696,788	\$115,552	110	11,000
Exxon Mobil	\$17,495,119	\$161,562	108	69,600
Anadarko Petroleum	\$16,959,896	\$160,251	106	4400
Entergy	\$13,158,220	\$124,050	106	13,504
Realogy Holdings	\$6,038,389	\$57,295	105	11,800
American Electric Power	\$11,530,461	\$113,084	102	17,666
Chemours	\$9,944,171	\$98,086	101	7000
Henry Schein	\$7,226,785	\$71,304	101	22,000
World Fuel Services	\$5,508,381	\$55,741	99	5,000
Apache	\$14,433,373	\$145,954	99	3,356
Consolidated Edison	\$16,047,911	\$168,028	96	15,591
Gilead Sciences	\$15,438,459	\$165,007	94	10,000
Southwest Airlines	\$7,560,200	\$81,177	93	56,100
Olin	\$1,079,700	\$78,838	92	6,400
Kraft Heinz	\$4,194,179	\$46,006	91	39,000
FirstEnergy	\$15,281,885	\$170,299	90	15,617
Zimmer Biomet Holdings	\$5,390,947	\$61,496	88	18,200
Nvidia	\$12,993,532	\$147,640	88	8,191
Williams	\$10,620,236	\$124,648	85	5,425

Company Name	CEO Pay	Median Worker Pay	Reported Ratio (:1)	Employees
Ally Financial	\$8,848,062	\$105,515	84	7900
CenterPoint Energy	\$8,024,525	\$96,573	83	8000
CDW	\$6,987,003	\$85,701	82	8726
Public Service Enterprise Group	\$10,621,115	\$132,480	80	12,945
NRG Energy	\$9,049,662	\$112,446	80	5490
United States Steel	\$5,618,557	\$72,635	77	29,200
HollyFrontier	\$9,907,151	\$131,612	75	3,522
M&T Bank Corp.	\$4,167,972	\$57,571	72	16,794
EOG Resources	\$10,573,685	\$146,016	72	2664
Ameren	\$8,080,790	\$122,003	66	8615
Edison International	\$9,794,301	\$157,112	62	12,521
PG&E Corp.	\$8,597,220	\$140,263	61	23000
PBF Energy	\$8,923,488	\$149,953	60	3,165
Huntington Ingalls Industries	\$7,974,179	\$132,546	60	38,000
Amazon.com	\$1,681,840	\$28,446	59	566,000
Markel	\$2,369,922	\$41,285	57	15,600
Cincinnati Financial	\$4,978,956	\$91,647	54	4,925
Oneok	\$5,608,945	\$105,847	53	2,470
Targa Resources	\$5,321,895	\$103,207	52	2130
NVR	\$3,538,600	\$69,147	51	5200
CMS Energy	\$6,862,295	\$167,636	41	7,822
XPO Logistics	\$1,384,021	\$36,885	38	95,000
Old Republic International	\$2,644,635	\$71,948	37	8,700
Host Hotels & Resorts	\$6,224,265	\$179,574	35	205
salesforce.com	\$4,653,362	\$155,284	30	29,401
Berkshire Hathaway	\$100,000	\$53,510	2	377,000

Appendix 2

Sector Definitions from Vanguard:⁶³

Consumer Discretionary

Companies that manufacture products and provide services that consumers purchase on a discretionary basis.

Consumer Staples

Companies that provide direct-to-consumer products that, based on consumer purchasing habits, are typically considered nondiscretionary.

Energy

Companies involved in the exploration and production of energy products, such as oil, natural gas, and coal.

Financials

Companies that provide financial services.

Health Care

Companies involved in providing medical or health care products, services, technology, or equipment.

Industrials

Companies that convert unfinished goods into finished durables used to manufacture other goods or provide services. A product which lasts 1–3 years is considered 'durable.'

Information Technology (Technology)

Companies that serve the electronics and computer industries or that manufacture products based on the latest applied science.

Materials

Companies that extract or process raw materials.

Telecommunication Services

Companies that provide telephone, data-transmission, cellular, or wireless communication services.

Utilities

Companies that distribute electricity, water, or gas, or that operate as independent power producers.

Endnotes

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- 7 "Letter to SEC Chair Mary Jo White." *Congressman Keith Ellison*. (March 18, 2015). Online at: https://ellison.house.gov/sites/ellison.house.gov/files/wysiwyg_uploaded/2015%20March%2017%20Ellison%20Grijalva%20Waters%20CEO-median%20worker%20pay%20ratio%20letter....pdf.
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CONGRESSMAN KEITH ELLISON Representing Minnesota's 5th District

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Questions for the Record Submitted by Rep. Joyce Beatty (OH-03)**Question #1:**

Since assuming your role as Chairman of the Securities and Exchange Commission, you have sought several regulatory and policy changes within the Commission. Section 342 of the Dodd-Frank Wall Street Reform and Consumer Protection Act established an Office of Minority and Women Inclusion within the Commission to increase workplace diversity, supplier diversity, and diversity among the Commission's regulated entities. The following questions seek to understand the role of the OMWI within the Commission under your leadership.

1. Have you met with the Commission's OMWI Director? If so, when was the last time you met and how often do you meet?

Response:

Yes, I meet regularly with the Commission's Office of Minority and Women Inclusion (OMWI) Director, Pamela Gibbs. Ms. Gibbs participates in my Senior Staff meetings, which are generally held every week. In addition, I hold quarterly one-on-one meetings with Ms. Gibbs, which have provided me the opportunity to stay on top of the office's ongoing activities and initiatives. Ms. Gibbs and I have also met on a number of other occasions to discuss ad hoc or time-sensitive matters. I've also attended OMWI staff meetings where I've had the chance to meet and talk with the dedicated staff who works in the office.

I also interact regularly with Ms. Gibbs through our shared leadership role on various employee affinity groups. I speak at events organized by OWMI or our staff affinity groups throughout the year, and I am currently the Commissioner sponsor of three SEC staff affinity groups (the African American Council; the Hispanic and Latino Opportunity, Leadership, and Advocacy Committee; and the Veterans Committee). Finally, over the past year, Ms. Gibbs and I have worked together to develop a new agency initiative designed to promote mentorship opportunities within the staff. We kicked off these efforts in January 2018 by organizing a roundtable on mentoring where we discussed potential objectives and methods for promoting mentorship opportunities at the SEC.

2. How many employees work within the Commission's OMWI? Please provide a brief job description of each position within the office.

Response:

Currently, the permanent staff of the Commission's OMWI is comprised of nine employees. The job titles and job descriptions of the OMWI staff are as follows:

Director - provides leadership and strategic direction for all the Commission's diversity and inclusion efforts; oversees the execution of programs and operations needed to build and maintain a diverse workforce, foster an inclusive work environment, promote the utilization of minority-owned and women-owned businesses in the Commission's business activities,

implement standards for assessing diversity policies of regulated entities, and carry out other responsibilities specified in Section 342 of the Dodd-Frank Act; establishes and monitors standards for performance to ensure workforce and supplier diversity objectives are achieved in a manner consistent with applicable policies, regulations, and statutes; represents the Commission in senior-level interagency meetings and projects, and meetings and conferences of external organizations.

Deputy Director – serves as senior manager on a broad range of functions supporting OMWI’s programs and operations needed to carry out responsibilities under Section 342 of the Dodd-Frank Act; serves as expert resource providing advice and assistance to agency management and staff on internal and external diversity matters; represents the Commission at meetings and conferences with other government agencies and external organizations; provides first line supervision to OMWI staff; ensures OMWI staff adhere to policies, procedures, and internal controls to monitor, evaluate, and as necessary improve OMWI’s operations.

Senior Counsel - provides legal advice and assistance for OMWI’s programs and operations; reviews for legal sufficiency and accuracy all material prepared by OMWI staff; drafts administrative regulations, policy documents, Federal Register notices, testimony, and responses to correspondence; reviews relevant rulemakings proposed by other Commission divisions and offices and proposed regulations of other federal agencies; ensures OMWI compliance with Paperwork Reduction Act, Freedom of Information Act, Privacy Act, and SEC rules and policies on OMWI-related matters.

Attorney Adviser- provides legal advice and assistance for OMWI’s programs and operations; reviews relevant rulemakings proposed by other Commission divisions and offices; reviews diversity-related training materials for legal sufficiency and accuracy; develops and presents diversity-related training to Commission employees; conducts post-award contract reviews to determine contractors’ compliance with their contractual obligations to ensure the fair inclusion of women and minorities in the contractor’s workforce; drafts testimony, speeches, and responses to correspondence.

Supplier Diversity Officer (two positions) – plans and executes initiatives to increase utilization of minority-owned and women-owned businesses in the Commission’s programs and contracts; conducts outreach and provides technical assistance to minority-owned and women-owned businesses interested in doing business with the Commission; hosts Vendor Outreach Days with staff from the Office of Acquisitions to provide prospective contractors an opportunity to learn about Commission’s contracting needs and present their business capabilities; participates in external business networking events, business conferences and procurement matchmaking sessions; maintains electronic database to collect up-to-date business information from diverse suppliers; conducts post-award reviews to determine contractors’ compliance with their contractual obligations to ensure the fair inclusion of women and minorities in the contractor’s workforce.

Data Analyst – collects, monitors, analyzes, and reports on data related to workforce composition and full spectrum of personnel activities; produces quarterly workforce

demographic profiles for each Commission division and office; prepares presentations for Director's diversity briefings with other senior officials; compiles statistical data and analysis for Annual Report to Congress; retrieves and analyzes data from Federal Procurement Data System to monitor supplier diversity performance metrics; obtains and analyzes applicant flow data from Office of Personnel Management to determine diversity in applicant pools for vacancies.

Program Manager – plans and coordinates diversity-related training for the Commission, working with SEC University in the Office of Human Resources; serves as liaison to eight of the Commission's nine Employee Affinity Groups (EAG); provides program support for the eight EAGs, including assistance with planning SEC-sponsored programs to commemorate special observance heritage months; reviews communications and announcements related to EAG programs and activities; conducts post-award reviews to determine contractors' compliance with their contractual obligations to ensure the fair inclusion of women and minorities in the contractor's workforce; coordinates yearly the Commission's partnerships with urban high-schools to enhance financial literacy programs and mentoring.

Program Support Specialist – performs a variety of administrative and management support operations such as human resources, budgeting, and procurement; approves and monitors government purchase card; monitors internal controls to ensure effective and efficient use of resources; serves as focal point for office communications; coordinates participation of employee volunteers for diversity outreach events.

3. Who is the OMWI Director's direct superior? If it is not the Chairman, please provide a legal justification for compliance with Section 342(b)(1) of Dodd-Frank.

Response:

The OMWI Director reports directly to me. On day-to-day operational and administrative matters, the OMWI Director also consults with the Chief of Staff, Deputy Chief of Staff, and Managing Executive for the Office of Chairman.

4. Have you met with, or received input from, the Commission's OMWI Director in preparation of publicizing your Notice of Proposed Rulemaking regarding Regulation Best Interest (17 CFR 240)?
 - a. If so, what was the nature of those conversations? If not, please provide a legal justification for compliance with Section 342(b)(3) of Dodd-Frank.

Response:

In April 2018, the Commission proposed a package of rulemakings and interpretations that are designed to enhance the quality and transparency of investors' relationships with their broker-dealers and investment advisers while preserving access to a variety of types of advice relationships and investment products. To solicit feedback from retail investors about the proposed rules and their experiences with investment professionals, I asked Commission staff to put together a series of roundtables to be held in different cities around the country. The

roundtables are intended to help us gather much-needed information from those who will be impacted most directly by the rulemakings. Seven roundtables have taken place in Houston, Atlanta, Miami, Washington, D.C., Philadelphia, Denver, and Baltimore.

OMWI has worked closely with the Office of Investor Education and Advocacy (OIEA) and SEC Regional Directors to help ensure that all segments of the investing public have an opportunity to participate in these events. OMWI supported our largest roundtable and town hall event in Atlanta held on June 13, 2018, by conducting outreach to minority- and women-focused organizations and educational institutions. Most recently, OMWI has been involved in organizing the roundtable that was held at the Reginald F. Lewis Museum of Maryland African American History & Culture in Baltimore on September 20, 2018.

Question #2

In your written testimony, you devote a section to improving disclosure effectiveness, specifically with regards to the requirements in Regulation S-K. You also stated that the Division of Corporation Finance is preparing recommendations for the Commission to finalize the S-K disclosure requirements as a result of the Fix America's Surface Transportation (FAST) Act.

Last time you were before this Committee, I submitted a Question for the Record regarding a December 2016 SEC Advisory Committee on Small and Emerging Companies recommendation for the Commission to amend Item 407(c)(2) of Regulation S-K to require issuers to describe the extent to which their boards are diverse and require them to include each board member's race, gender and ethnicity, to the extent individual directors self-identify. You replied that you asked the Division of Corporation Finance to continue to monitor disclosures in this area and make recommendations.

Do you have any update on where the Commission is with regards to the original recommendation made by the Advisory Committee on Small and Emerging Companies regarding diversity disclosures?

Response:

Board diversity disclosure appears on the Commission's published long-term rulemaking agenda and is an important issue. In February 2017, the Advisory Committee provided their recommendation to then-Acting Chairman Piwowar. Subsequently, I asked the Division of Corporation Finance to look at what disclosures companies are providing and how companies are approaching the issue. In conversations with issuers, several additional considerations have been raised, including sensitivity to board members' privacy interests in terms of self-identifying on race, gender, or ethnicity. Our goal is to approach this subject in a thoughtful manner, and we continue to study the relevant issues.

Question #3

In your written testimony, you briefly discuss efforts by Congress and the Commission to further develop a capital formation ecosystem that includes a scaled disclosure regime and provides

small- and medium-sized businesses additional capital raising avenues while maintaining robust investor protections, such as Regulation A+. In April, you submitted a letter to Chairman Hensarling and Ranking Member Waters, pursuant to requirements of the JOBS Act, which stated you had accepted the staff's recommendation to not increase the \$50 million Regulation A+ offering limit.

There have been several articles published by Bloomberg, the Wall Street Journal, and Barrons that have highlighted several issues with companies utilizing the Regulation A+ offering and have highlighted the fact that the average stock price of a publically-traded company that has went public through Regulation A+ is down 50% since listing (e.g., a Bloomberg article entitled, "The Dangerous World of Tiny IPOs" which highlights companies run by people who have been convicted of robbing investors in the past and a company formed by the founder of a rock band to raise money to study UFOs and light-speed travel or the public company LongFin, which the SEC recently had to freeze trading in because of illegal distributions and sales of restricted shares of stock).

1. Can you briefly discuss why you sided with the two Democratic commissioners to maintain the \$50 million cap on Reg A+ offerings?
2. Are you at all concerned by the negative press and extremely poor performance of some of the public companies that have used the Reg A+ process?
3. Are these the types of companies we want mom and pop investors to invest in? What can we do to improve the Reg A+ regime to make it more legitimate, because right now it is almost a scarlet letter for any company that utilizes this method for raising capital?

Response:

Section 401 of the Jumpstart Our Business Startups Act (JOBS Act) directed the Commission to adopt rules exempting securities offerings of up to \$50 million annually from the registration requirements of the Securities Act of 1933 (Securities Act). On March 25, 2015, the Commission adopted final rules to implement this requirement, creating the "Tier 2" offering exemption under Regulation A that became effective on June 19, 2015. Section 401 of the JOBS Act also added Section 3(b)(5) to the Securities Act, which requires the Commission to review the \$50 million offering limit for these Tier 2 offerings not later than two years after enactment of the JOBS Act and every two years thereafter. If the Commission determines not to increase the offering limit, it is required to report its reasons for not increasing such amount to Congress.

In April 2018, the Director of the Division of Corporation Finance, William Hinman, sent a letter to Congress to report that the Commission had determined at that time not to propose to increase the \$50 million offering limit. The primary basis for this determination was the lack of available data on completed Regulation A offerings to date. As the letter stated, approximately 80% of filers with qualified Regulation A offerings at the time of our determination had not yet completed their offerings or reported the amounts raised in completed offerings. Due to the time lapse between qualification of the offerings and the availability of reports of proceeds for completed offerings, the Commission was unable to derive definitive conclusions as to the

adequacy of the existing \$50 million offering limit, or to forecast the amount of capital that typically will be raised through Regulation A offerings conducted in the future.

I remain committed to the Commission's continued efforts to facilitate capital formation, particularly by smaller companies, which can provide Main Street investors with more direct investment opportunities without sacrificing important investor protections. As explained in Mr. Hinman's letter, I have directed the staff of the Division of Corporation Finance and the Division of Risk and Economic Analysis to continue monitoring the Regulation A market and gathering additional information about the use of Regulation A, including data on completed offerings and the experiences and suggestions of issuers, investors, and other market participants, to determine whether to recommend proposing to increase the Regulation A aggregate annual offering limitation. Under Section 3(b)(5) of the Securities Act, the next review of the Regulation A offering limit is required to be conducted by 2020, but I have requested that the staff instead do so in 2019 as part of my commitment to help facilitate capital formation.

I am aware of and concerned by news reports relating to the poor performance of certain companies that have issued securities in reliance on Regulation A. While we continue to see steady growth in the number of Regulation A offering statements filed with the Commission, we are mindful of the need to maintain investor protection—a key component of investor confidence—in the market for Regulation A securities and the integrity of the companies active in that market so that it continues to be a healthy, cost-effective means of capital formation.

In addition to the statutorily mandated review of the offering limit, at the time the Regulation A amendments were adopted, we committed that the staff would undertake to study and submit a report to the Commission no later than five years after adoption on the impact of Regulation A offerings on capital formation and investor protection. I also anticipate that staff will consider the effectiveness of Regulation A as part of a comprehensive review of our exemptive securities offering framework I recently announced. Overall, I expect that the staff review and any resulting proposals with respect to the Regulation A exemption will give serious consideration to any issues that may be impacting the effectiveness of the exemption as a capital raising tool and to whether any additional investor protections are necessary.

Questions for the Record Submitted by Rep. Ted Budd (NC-13)**Questions:**

1. Can you provide any additional detail on how the Commission plans to proceed to raise shareholder resubmission thresholds as outlined in Mr. Duffy's bill (H.R. 5756) and recommended in the October 2017 Treasury report? Given that the changes simply involve raising thresholds, isn't this something that the Commission can update outside of the proxy plumbing framework and act on quickly?

Response:

In July 2018, I announced that the Commission staff will host a roundtable, to be held on November 15, 2018, to hear from investors, issuers, and other market participants about whether the Commission's proxy rules should be refined. I have asked the staff to consider a variety of topics affecting shareholder engagement and the proxy process at the roundtable, including the shareholder proposal process. In particular, I have asked that staff specifically look at whether the current thresholds for minimum ownership (*e.g.*, shares held and length of time) to submit a proposal to be included in the company's proxy statement appropriately consider the interests of all shareholders, taking into account the potential benefits to shareholders of a proposal (or resubmission) being considered or adopted, as well as the costs associated with the inclusion of a proposal (or resubmission) in the proxy statement. Further, I have asked the staff to consider whether rules that allow companies to omit resubmitted proposals that received less than 3%, 6%, or 10% of the vote, depending on how many times the subject matter has been voted on in the last five years, are appropriate.

There are many strongly held and conflicting views on this issue, and it is important for us to be mindful of facilitating shareholders' ability to submit proposals that may benefit the company and its shareholders and the costs borne by companies and other shareholders in processing those proposals. It is also important to consider whether our rules and processes in this area are serving the long-term interest of Main Street investors, and the roundtable is intended to facilitate that type of assessment.

I expect that roundtable participants and other interested parties will submit comments with recommendations for potential Commission action, including adjusting the current resubmission thresholds. I look forward to the feedback from participants at the roundtable and future recommendations from staff on ensuring that the proxy process is meeting the needs of shareholders and issuers.

2. What information is made available to shareholders and the public by the Commission about how public companies are managing their risk beyond financial reporting?

Response:

The issue of risk management at our public companies is important, and I believe increasingly so, particularly in areas such as cybersecurity and dependency on third party service

providers. I also believe shareholders should receive material information regarding risk management, including risk assessment.

In this regard, registrants must comply with our disclosure requirements under the federal securities laws. In addition to certain financial reporting requirements, risk-related disclosure is addressed by a number of SEC rules and regulations. For example, Item 407(h) of Regulation S-K and Item 7 of Schedule 14A require a company to disclose the extent of its board of directors' role in the risk oversight of the company, such as how the board administers its oversight function and the effect that this has on the board's leadership structure. The Commission specifically noted this requirement in its February 2018 Statement and Guidance on Public Company Cybersecurity Disclosures, where it stated that to the extent cybersecurity risks are material to a company's business, the disclosure should include the nature of the board's role in overseeing the management of that risk.

Other disclosure requirements call for further information on the risks faced by registrants. Item 503(c) of Regulation S-K requires disclosure of the most significant factors that make an investment in a registrant's securities speculative or risky. Moreover, Item 305(b) of Regulation S-K requires registrants to describe, to the extent material, their primary market risk exposures, how those exposures are managed, and any changes to either the primary market risk exposures or the way that risk exposures are managed. Our rules also require, in addition to the information expressly required to be included in a filing, disclosure of further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made, not misleading. In light of these requirements, some registrants also describe other risk management practices in filings.

House Committee on Financial Services
“Oversight of the U.S. Securities and Exchange Commission”
June 21, 2018

Questions for the Record Submitted by Congressman Tom Emmer (MN-06)

Mr. Chairman, in past statements you have said that cryptocurrencies are “replacements for sovereign currencies,” and that “that type of currency is not a security.”

To the extent any particular cryptocurrency is not a security, is this determination made because the design-goal of the cryptocurrency is to be a currency that could replace sovereign money or is this determination made because the cryptocurrency is both functional and decentralized, as described by Director Hinman in a recent speech?

Do you think it is possible for a token or cryptocurrency to not be a security if it is decentralized and functional, as described by Director Hinman, but was not designed to be a replacement for sovereign currency? We are thinking specifically of decentralized tokens developed to offer computing services, identity tools, or other goods whose use as a currency may be secondary or even non-existent.

Response:

Whether a cryptocurrency, token, coin, or any other digital asset is a “security” for purposes of the federal securities laws is determined by applying long-established law to the facts and circumstances of the particular instrument being sold. Under Supreme Court case law, *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946), and its progeny, where purchasers make an investment of money in a common enterprise with an expectation of profits derived from the efforts of others, the asset the investor receives in return for the investment—whether labeled a “stock”, “bond”, “contract”, “instrument”, “token”, “coin” or “digital asset”—is a security. Determining whether, under the *Howey* test or other analytical frameworks, an asset is a security generally requires an assessment of the facts and circumstances, including the economic rationale underlying the relevant purchase and sale transaction and the parties’ expectations.

I believe the speech by our Division of Corporation Finance Director William Hinman appropriately addressed a number of the considerations in evaluating whether a digital asset is a security. In theory, I agree that you could have a digital asset that is sold only to be used to purchase a good or service available through the network on which it was created, consistent with the hypothetical posed in your question. If the network on which the token or coin is to function is sufficiently decentralized—where purchasers do not or would no longer reasonably expect a person or group to carry out essential managerial or entrepreneurial efforts—the assets may not represent a security under the *Howey* test. It is important to note that the analysis of whether something is a security is not static and does not strictly depend on the type of instrument. Even digital assets with utility that function solely as a means of exchange in a decentralized network could be packaged and sold as an investment strategy that could be a security.

We have encouraged those interested in these issues to reach out to the SEC staff. Our staff has built significant expertise on these issues, and we recently named a new Associate Director in the Division of Corporation Finance to serve as Senior Advisor for Digital Assets and Innovation to coordinate efforts in this area across the agency.¹ In addition, we recently launched the SEC's new Strategic Hub for Innovation and Financial Technology ("FinHub"), which will serve as a resource on these and other FinTech-related issues and facilitate engagement with investors and market participants. Our door remains open to those who seek to innovate and raise capital in accordance with the law.

¹ See Press Release 2018-102, SEC Names Valerie A. Szczepanik Senior Advisor for Digital Assets and Innovation (June 4, 2018), available at <https://www.sec.gov/news/press-release/2018-102>.

Question for the Record Submitted by Rep. Blaine Luetkemeyer (MO-03)

In its recent October 2017 Capital Markets report, Treasury emphasized that the risk retention regulations should not be static, noting the importance of creating appropriate risk retention exemptions for low risk asset classes:

“...banking regulators expand qualifying risk retention exemptions across eligible asset classes based on the unique credit characteristics of each securitized class, through notice and comment rule making. Well documented and conservatively underwritten loans and leases, regardless of asset class, should not require signaling, through retention, from the sponsor as to the credit worthiness of the underlying collateral”.

Will you comment on the possibility of the SEC re-opening the issue of risk retention to make it more merit-based, where conservatively underwritten loans, across other asset classes, can have a chance to gain an exemption from the rule?

Response:

I believe that the Department of the Treasury’s Core Principles reports clearly and comprehensively frame many of the key issues in our financial markets. These reports have made an extremely valuable contribution to the SEC’s mission, and, importantly, to investors and our capital markets. I commend Secretary Mnuchin and Counselor Phillips for their work on these reports.

Pursuant to Section 941 of the Dodd-Frank Act, the risk retention rules were jointly adopted in 2014 by six federal agencies, including the Commission and the Federal banking agencies. Section 941 allows the Commission and the Federal banking agencies to establish asset classes for securitizations to which a lower risk retention requirement may apply if the underlying loans meet underwriting standards indicating a low credit risk (“qualifying assets”). However, Section 941 allocates the authority for writing the rules to implement its provisions among the six agencies in various ways. Under the statute, the Federal banking agencies have the authority to specify the underwriting standards for qualifying assets. As a result, the Federal banking agencies, rather than the Commission, are the appropriate agencies to consider, in the first instance, whether there is a basis for creating additional exemptions for qualifying assets of other asset classes.

However, recognizing the importance of input from investors and other market participants to help us assess whether our rules are accomplishing their intended goals, our door is always open to discuss this and other issues with our fellow regulators and other market participants.

Questions for the Record Submitted by Rep. Brad Sherman (CA-30)**Questions:**

1. In your experience, are the majority of ICO's conducted pursuant to an exemption from registration, or are they operating illegally?
2. What are some of the enforcement challenges the SEC faces in the unregistered ICO market?
3. What specific steps is the SEC taking to overcome these challenges and ensure effective policing of the ICO markets?

Response:

The federal securities laws provide that all offers and sales of securities must be registered with the SEC or qualify for an exemption from SEC registration. Whether a particular ICO is a security, and if so whether it qualifies for an exemption, depends on the facts and circumstances of the offering. Just as with any offer and sale of securities, the Commission will bring enforcement actions where appropriate for violations of the federal securities laws, including the registration provisions. The requirement to register securities offerings (and its twin, the registration exemption for private placements) are at the core of our regulatory system. This approach has served us well, facilitating capital formation while maintaining a high level of investor protection—both at levels that are world-leading.

The staff in the Division of Enforcement (Enforcement) continues to investigate and, where appropriate, recommend enforcement actions for violations of our registration requirements and other laws, including anti-fraud laws, vigorously. Enforcement cases involving digital assets date back to 2013, and include cryptocurrency-denominated Ponzi or other fraudulent investment schemes, unregistered offerings, and unregistered trading platforms. Last year, we formed a Cyber Unit in Enforcement to focus its considerable expertise on ICOs and other cyber-related activity.

The Commission has brought a number of ICO cases against issuers and individuals for alleged unregistered offerings, certain of which also allege fraud. The Commission has obtained asset freezes in emergency actions and staff continues to partner with criminal authorities to halt fraudulent ICO schemes. The Commission also has issued more than a dozen trading suspensions for publicly traded companies, largely as a result of questions regarding the accuracy of the assertions these companies were making about their blockchain-related business plans.

The ICO market does pose enforcement challenges, particularly as a result of its rapid ascendancy in 2016 and 2017, its use of the internet to engage with retail investors directly and broadly and the international nature of the market. For example, because transactions may be conducted largely outside the United States, witnesses and evidence may be located offshore, and our ability to access information therefore may be limited. Tracing the flow of digital asset transactions may be more difficult because centralized and traditional financial institutions often are not involved. Certain entities that are involved in the flow of funds may not keep customer

and trading records. The anonymity provided by digital assets may make it hard to attribute conduct to any particular individual or entity, and this challenge will be exacerbated with the use of digital assets that have enhanced anonymity features. There also are challenges with seizing, freezing, and recovering digital assets. I have, on multiple occasions, specifically cited these issues in warning investors about the various risks presented by ICOs, including in a statement I issued in December 2017.

In addition to these statements, the staff has issued various statements and taken other initiatives that highlight investor protection and market integrity concerns in this area. As just one example of our messaging in this area, the Office of Investor Education and Advocacy published a mock ICO website that touts a “too good to be true” investment opportunity and mimics a bogus coin offering to educate investors. Any attempt to invest takes a would-be investor to educational materials concerning ICOs.

In the area of prevention, we also have made it clear to professional service providers (*e.g.*, auditing firms, underwriters, and lawyers) that we expect them to provide services in accordance with our laws. If they do not, I expect we will bring enforcement actions.

We also recognize that developing staff expertise, both within Enforcement’s Cyber Unit, as well as across the agency, is important to the Commission’s ability to focus on developments in this space. We are committed to developing this expertise and have made significant progress in the past 18 months.

Finally, to address challenges related to the global scope of cryptocurrencies and ICOs, the Commission and staff coordinate with its domestic and foreign regulatory and law enforcement counterparts on approaches in this area.

4. In thinking about disclosure of cybersecurity and cybersystems, certainly disclosure should be meaningful, balanced, and have a focus on the core of the entity’s brand, mission and market value. What is the appropriate disclosure regime?

Response:

In light of the increasing significance of cybersecurity incidents, the Commission issued interpretative guidance in February 2018 to assist public companies in preparing disclosures about cybersecurity. The Commission’s guidance highlights the disclosure requirements under the federal securities laws that public companies must evaluate when considering their disclosure obligations with respect to cybersecurity risks and incidents. The staff in the Division of Corporation Finance, through its filing review process, continues to monitor carefully public companies’ cybersecurity disclosures.

The existing disclosure framework seeks to elicit disclosure of cybersecurity incidents and risks that are material to investors in a timely fashion. At the same time, the disclosure regime is flexible enough to allow companies to make their own determination about how and when disclosure is needed. Generally, the determining factor is whether the information would be viewed by the reasonable investor as important in making an investment decision or as having

significantly altered the total mix of information available. As the cybersecurity landscape and the risks associated with it continue to evolve, the Commission and staff will continue to evaluate the guidance in light of such disclosures, the cybersecurity environment, and its impacts on issuers and the capital markets generally and consider feedback about whether any further guidance or rules are needed.

5. Chairman Clayton, can you give us an update as to where Regulation Best Interest is in the process?

Response:

In April, the Commission voted to propose a comprehensive package of rulemakings and interpretations designed to enhance the quality and transparency of the relationships retail investors have with their investment professionals, while preserving access, in terms of both availability and cost, to a variety of types of investment services. The proposed rulemaking package includes a robust 90-day request for comment on all aspects of the package. In order to hear first-hand from retail investors who will be directly impacted by the rulemaking package, we have conducted a number of roundtables across the country to provide Main Street investors the opportunity to tell us about their experiences and views on what they expect from their investment professionals. The transcripts from these roundtables are included in the comment file. We also have invited investors to share their insights and feedback with the Commission by going to <https://www.sec.gov/tell-us>. In addition, our Office of Investor Advocate engaged RAND Corporation to perform investor testing on aspects of the rulemaking package, including Form CRS. The results of the investor testing were recently made available on the SEC's website in order to allow the public to consider and comment on this supplemental information.

The staff of the Division of Trading and Markets and the Division of Investment Management are reviewing all comments received, which is over 6,000 to date. While the comment period ended on August 7, 2018, the rules' comment files continue to receive and publish public comments, and the staff will continue to consider the rulemaking record as it develops a recommendation.

6. Despite the SEC's prediction in 2006 that the Acquired Fund Fees and Expenses rule would not harm capital formation and would benefit investors, do you agree that the removal of Business Development Companies (BDCs) from two major indices has reduced BDC institutional ownership, as well as market depth and liquidity for all investors?
7. Because of the small size of the BDC industry at the time, with only 5 existing BDCs when the Acquired Fund Fees and Expenses rule was proposed, is it possible that the SEC did not thoroughly analyze or understand the impact of the rule on the BDC industry?
8. Now that we have seen clearly the impacts of the rule on the industry, and because BDCs in fact operate almost identically to REITs, which are exempted from the Acquired Fund Fees and Expenses Rule, are you, Chairman Clayton, open to making changes either through regulation or guidance, to provide a similar exclusion for BDCs?

Response

The Acquired Fund Fees and Expenses (AFFE) requirement, adopted by the Commission in 2006, requires registered investment companies (acquiring funds) that invest in underlying funds, including BDCs and private funds, to disclose in their fee tables the expenses of these underlying funds. The AFFE requirement is designed to help investors understand and compare the costs of investing in an acquiring fund to the costs of investing in a registered fund that doesn't invest in underlying funds.

Funds that invest in other funds can have duplicative expenses, such as advisory fees, which are charged directly at the acquiring fund level and indirectly at the underlying fund level. The AFFE requirement was intended to provide investors with better disclosure about these indirect costs to help them make more informed investment decisions.

When the Commission proposed the AFFE requirement, it stated that these disclosures "should promote more efficient allocation of investments by investors and more efficient allocation of assets among competing funds because investors may compare and choose funds based on their preferences for cost more easily." The Commission also sought comment on its proposed analysis of potential effects of the rule on competition, efficiency and capital formation. However, during the comment period after the AFFE requirement was proposed in October 2003, none of the 18 BDCs that were publicly traded that year (or other non-publicly traded BDCs) commented on the proposal.

Nevertheless, I understand that BDCs have since come to play a more significant role in capital formation, particularly in middle-market lending. In addition, I am aware that there have been developments since the AFFE requirement was adopted, including exclusion of BDCs from major market indices, that neither BDCs nor the Commission may have anticipated when the AFFE requirement was adopted.

The Coalition for Small Business Growth, whose members include certain BDCs, has asked Commission staff to consider relief from the AFFE requirement that would allow acquiring funds to exclude BDC expenses from their fund fee tables. Staff is actively engaged with the Coalition to understand better the particular challenges that mutual funds which may desire to invest in BDCs experience with the AFFE requirement and to evaluate how well the requirement is achieving the Commission's policy goals. I look forward to continuing the dialogue on this subject.

Questions for the Record Submitted by Rep. Scott Tipton (CO-03)**Automation**

Background: The financial services industry, in particular back office and middle office processes, is not fully automated and often relies on manual methods (e.g., to enter data into a system or to communicate between systems). Further communication to clients, even to sophisticated institutional clients, is still done in many instances by PDF, email, and even fax. The failure to fully automate these functions where such technology exists and is tested can lead to significant delays to settlement times, increase the number of trade errors, unnecessarily increase costs for clients, and potentially introduce unnecessary risk into the system. For example, standing settlement instructions (SSIs) use manual methods for client communication and issues related to the use of such methods are often cited as one of the leading causes of trade failures & exceptions because the SSIs are inaccurate or out of date.

Question:

While not everything may be ripe for full automation, automation can offer clear benefits, including low cost, ease of use, and reduced trade errors, especially when time is taken to understand and mitigate the risks and limitations of such automated processes before using them. What can the SEC do to bring these outdated functions into the 21st century?

Response:

In the clearance and settlement area, the Commission has pursued a number of initiatives that create the potential for increased automation. These initiatives have focused on reducing settlement times and the overall number of trade errors. For example, in 2017, the Commission adopted rule amendments to shorten the standard settlement cycle for most broker-dealer transactions from three business days after the trade date (“T+3”) to two business days after the trade date (“T+2”). Comments on this initiative noted that a shorter settlement cycle would motivate market participants to improve their operational processes by increasing automation and straight-through processing. In adopting the proposal, the Commission agreed with these comments that a shortened settlement cycle would result in the development and use of more efficient operational processes.

In addition, with respect to institutional trades, matching service providers have helped facilitate a significant evolution in the institutional trade settlement process, which was originally carried out directly between the broker-dealer and the institution with little or no automation. Virtually all institutional trades are now processed through electronic systems, and matching service providers further supports a move towards automation by actively comparing trade and allocation information to issue an affirmed confirmation that is used to settle a trade. In 2015, the Commission granted an exemption from registration as a clearing agency to two new matching service providers. In providing these exemptions, the Commission noted that the availability of multiple matching service providers provides market participants with more venues to match trades in a timely, efficient manner, increasing the potential for a higher global rate of affirmed trades during the settlement cycle and promoting a shorter settlement cycle. The

availability of matching service providers expands access to automated trade matching, which facilitates the settlement of trades by reducing errors and the amount of time needed to settle.

We will continue evaluating further initiatives to increase automation, both at the SEC and in other market functions more generally.

EU

Background: A U.S. Clearinghouse (CCP) doing business in Europe (EU) needs to obtain formal recognition pursuant to the European Market Infrastructure Regulation (EMIR) to be able to competitively provide clearing services to EU clearing members and customers. However, a CCP can only be recognized if the EU has found its regulatory regime to be “equivalent” to EMIR. In 2016, EU authorities found the CFTC regime to be “equivalent.” However, the SEC and the regulatory framework for clearing cash-securities, including U.S. Treasuries, has not yet been found to be “equivalent” and progress on this front has been met with frequent delays. Further complicating an SEC “equivalency” determination are draft revisions to EMIR that would bring U.S. and other third-country CCPs under the direct regulation and supervision of the EU for the first time. The stated purpose for making these changes is to address the potential risks that third-country CCPs could pose to the Europe’s financial system. The approach, however, could reopen the 2016 equivalence agreement for derivatives clearinghouse supervision between the CFTC and the EU authorities, which could further delay an SEC “equivalency” determination.

Question:

While it is difficult to measure the impact of European members pulling out of U.S. cash-market CCPs, it would undoubtedly negatively impact the functionality and liquidity of the U.S. Treasury market. How do you plan to address this situation? Can you describe the SEC’s efforts to work with the EU on an “equivalency” determination and the progress that has been made on this front?

Response:

Your question centers on an important issue that could have significant consequences for our markets if the European Commission (EC) does not deem certain SEC-regulated central counterparties (CCPs) equivalent. Currently, under Article 25(2)(a) of the European Market Infrastructure Regulation (EMIR), an “equivalence” decision is a necessary pre-condition to European Securities and Markets Authority (ESMA) recognizing U.S.-based, SEC-regulated CCPs. Specifically, an equivalence determination would enable ESMA to recognize U.S.-based, SEC-regulated CCPs so that European Union (EU) credit institutions and investment firms can continue to receive CCP services without incurring higher capital charges under new EU capital requirements and also would allow U.S.-based, SEC-regulated CCPs to provide CCP services to clearing members or trading venues established in the EU.

Since 2013, SEC staff has been in dialogue with EC staff regarding the potential for the EC to determine that the SEC’s regulatory regime for U.S.-based CCPs is equivalent to the

regulatory framework for CCPs set forth in EMIR. In September 2016, the SEC adopted standards for certain SEC-regulated CCPs that are consistent with the CPMI-IOSCO Principles for Financial Market Infrastructures,² which are the international standards for CCPs and other financial market infrastructures.

We believe the adoption of these standards should make it easier for the EC to complete its equivalence analysis of the SEC's regulatory regime for U.S.-based CCPs and reach an equivalence determination. However, the EC staff has not provided any indicative timeframe for its decision-making. SEC staff continues to engage with EC staff regarding a potential equivalence determination, and it has provided prompt responses to several information requests from EC staff. SEC staff stands ready to engage on these matters and will continue to provide information requested by the EC staff.

Swaps Reporting

Background: Dodd-Frank included requirements for the creation of swap data repositories (SDRs) to provide central facilities for swap data reporting and recordkeeping (including for security-based swaps). Under Dodd-Frank, all swaps, whether cleared or uncleared, are required to be reported to registered SDRs. The CFTC promulgated Part 49 regulations implementing Commodity Exchange Act Section 21. The SEC promulgated Rules 13n-1 to 13n-12 implementing the Securities Exchange Act of 1934 Section 13(n). Critically, the CFTC and SEC SDR rules differ in ways that could impede transparency into the swaps market.

Question:

A basic goal of Dodd-Frank financial reform was improving transparency into the swaps market. A full picture of the swaps market will require transparency into the derivatives swaps market and the securities based swaps market, which falls under the jurisdiction of the SEC. Both you and CFTC Chairman Giancarlo have indicated that your agencies are coordinating to achieve greater regulatory harmonization. Can you describe these efforts and the progress that has been made on this front?

Response:

Title VII of the Dodd-Frank Act gave the SEC regulatory authority over security-based swaps and certain key participants in that market, including "security-based swap dealers" and "major security-based swap participants." Title VII, among other things, amended the Securities Exchange Act of 1934 to address the registration and regulation of security-based swap dealers, the registration and duties of security-based swap data repositories, the reporting and public dissemination of security-based swaps, and the mandatory clearing and trade execution of certain security-based swaps, among other things.

The SEC has finalized many, but not all, of the Title VII rules that Congress directed it to establish. With respect to transaction reporting and transparency, the SEC adopted Exchange

² See Standards for Covered Clearing Agencies, Securities Exchange Act Release No. 78961 (Sept. 28, 2016), 81 FR 70786 (October 13, 2016).

Act Rules 13n-1 through 13n-12, which establish the procedures by which a swap data repository shall register with the SEC and certain “duties and core principles” to which a swap data repository must adhere. The SEC also adopted Exchange Act Rules 900 to 909 (“Regulation SBSR”), which provide for the reporting of security-based swap transaction data to registered swap data repositories, and the public dissemination of security-based swap transaction, volume, and pricing information by registered swap data repositories. The compliance schedule for Regulation SBSR is tied to, among other things, finalization of rules establishing recordkeeping and reporting and capital, margin, and segregation requirements for security-based swap entities. These rules have been proposed but not finalized.

The SEC remains committed to consulting and coordinating with the CFTC to the benefit of the markets and market participants we oversee. In this regard, I am pleased to note that CFTC Chairman Giancarlo and I recently executed a memorandum of understanding (MOU) between our two agencies. This MOU explicitly acknowledges where we have shared regulatory interests, including but not limited to Title VII, and reconfirms our commitment to work together to facilitate efficient markets for the benefit of all market participants.

The Commission also issued a statement on October 31, 2018, setting forth the Commission’s position that certain actions with respect to provisions of its Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants will not provide a basis for a Commission enforcement action for a limited time period. The statement also addresses the Commission’s position on the ability of parties to security-based swaps to rely on written representations previously provided in relation to swaps, also for a limited time period. The Commission’s statement is intended to minimize potential market disruptions to existing counterparty relationships resulting solely from documentation implementation issues that may arise when security-based swap dealers and major security-based swap participants are required to register with the Commission. Upon registration with the Commission, entities that are also registered with the CFTC will be required to comply with both the Commission’s Business Conduct Standards, as well as analogous rules adopted by the CFTC in 2012 applicable to swap dealers and major swap participants.”

I have asked the Commission staff to continue to consider ways to further harmonize our security-based swap rules with the CFTC, where appropriate, to increase effectiveness as well as reduce complexity and costs. This requires deliberate and constructive engagement with the CFTC. In some instances—in part because of statutory variances and differences in products and markets—the SEC’s final and proposed rules governing security-based swaps have differed from the rules governing swaps that the CFTC adopted pursuant to its Title VII mandates. We are initially focusing on a number of different areas of Title VII and recognize that further consistency across Title VII will further the goals of transparency as well as reduce complexity and costs. In addition, SEC staff has participated with the CFTC in international efforts to harmonize transaction identifiers, product identifiers, and critical data elements.

FIMSAC Recommendations

Background: Some industry analysis has described the difficulty investors are experiencing in gaining exposure to certain assets. In particular, in corporate bonds, there are reports that investors sometimes have to break up large orders into many smaller orders to find the liquidity, but that this longer execution process makes them vulnerable to market movements and higher costs. In January, the SEC launched the Fixed Income Markets Advisory Committee (FIMSAC), which is intended to look at fixed income markets for just these types of issues and make recommendations. In March, FIMSAC recommended running a pilot program related to the reporting of large transactions.

Question:

Are there are other issues you think the Committee should consider that could improve liquidity? What else do you think this Committee should consider with regard to electronic trading and bond funds, the topics of two of the Committee's subcommittees?

Response:

The Fixed Income Market Structure Advisory Committee's (FIMSAC) work is central to the Commission's effort to enhance the market structure for fixed income as we assess the efficiency and resiliency of these markets, including liquidity in the various facets of our fixed income markets. I have also emphasized the importance of focusing on Main Street investors as they are key participants in the corporate bond and municipal securities markets, both directly and indirectly through a variety of pooled investment vehicles.

I believe that the FIMSAC's focus on transparency, electronic trading and ETFs, and bond funds is appropriate, and the variety of issues it is considering within these topics could help improve liquidity in our fixed income markets, including the corporate bond market identified in your question. With respect to transparency specifically, the FIMSAC is analyzing several key topics. The FIMSAC has recommended that applicable rules around large trade reporting be analyzed through a pilot program to address the concerns you note regarding liquidity for larger orders. In addition to its recommendation for a pilot concerning large trades, I believe it is important to receive views from the FIMSAC regarding the current state of pre-trade transparency, with an eye toward informing the Commission about whether market participants have appropriate information to value bonds in a manner that supports a robust market infrastructure.

I also believe that the FIMSAC's Municipal Securities Transparency Subcommittee's focus on retail investor participation in municipal securities offering is important. I look forward to their views on how retail participation in municipal securities primary offerings can be promoted so that retail investors are able to acquire these assets on the best possible terms.

Additionally, the Committee's focus on issues pertinent to fostering a competitive and robust electronic trading environment is timely, as the market continues to evolve towards more electronic trading. The Commission staff has begun evaluating the first of these

recommendations, a comprehensive review of the current regulatory landscape for electronic trading venues.

Additionally, I believe prompt consideration should be given to the FIMSAC's recent recommendation for a centralized source of new issue reference data that is provided in real time to all reference data vendors and market participants, and I've asked the Commission staff to focus on this recommendation. In order to have confidence in electronic trading, market participants need timely access to accurate reference data, and this recommendation should help promote robust electronic trading infrastructures.

Finally, concerning electronic trading, I also look forward to the FIMSAC's continued consideration of practices in the bid-wanted auction market that may impair the quality of that market. Retail customers in the bond market rely heavily on the bid-wanted auction process when looking to sell bonds. Any market practices that negatively impact this important trading protocol must be assessed carefully, and I look forward to the FIMSAC's review of this issue.

Regarding bond funds and exchange-traded funds (ETFs), FIMSAC's ETFs and Bond Funds Subcommittee is working on several issues that I believe are worthy of consideration. For example, the FIMSAC has considered any potential impact of ETFs on liquidity and pricing of underlying bonds—especially in stressed markets, and the Subcommittee continues to assess it. In addition, the Subcommittee has made recommendations regarding investor education, ETF data, and the classification and labelling of exchange-traded products including ETFs.

Questions for the Record Submitted by Rep. Ann Wagner (MO-02)**Questions:**

1. On July 1, 2017, the State of Nevada implemented its own fiduciary rule after the delay of the DOL rule and after inaction by the SEC to implement a uniform fiduciary standard. In addition, other states such as New York, New Jersey, and Massachusetts were looking at developing their own state fiduciary standard.
2. Are you concerned about the potential impact a patchwork of state laws will have on the provision of retirement advice?
3. Now that the SEC has proposed their own best interest standard for broker-dealers, how will the SEC look at state action in this space as it moves forward?

Response:

The lack of regulatory consistency and coordination amongst multiple regulators continues to be a challenge with regard to the provision of investment advice to retail investors. Broker-dealers are currently, and would continue to be, subject to a variety of regulations, including the federal securities laws, SRO rules, and rules from other regulators such as the states. I recognize this lack of consistency among standards imposes costs on investors and the markets and, in many cases, it is not clear to me that either investor protection or investor opportunity are being enhanced by this patchwork approach to professional standards. Our markets, including the market for personal financial services, are largely national. As a result, I believe it is important that we pursue clarity, consistency, and collaboration as key elements of effective oversight and regulation in this important area.

I also believe that the SEC's proposed model—a rigorous standard that, in practice, can cover a range of relationship types—will produce high-quality advice where investment professionals cannot put their interests ahead of the interests of their clients while maintaining a range of cost-effective options for retail investors. More pointedly, I believe that our approach, including its clear framework, puts us in a good position to work with our fellow regulators at the federal and state levels to seek consistency and coordination across the entire spectrum of investment professionals and products—and we intend to work closely with them to promote regulatory harmonization.

4. The SEC is essentially creating two rules. One, an actual best interest standard for broker-dealers and two, the creation of a disclosure form that is required for broker-dealers and investment advisers when first engaging with a client. Based on my review of the proposal, I'm not sure these need to move together- if in fact the SEC needs more time to work on the best interest standard portion.

Do you see an option where the disclosure portion of the rule would move separate from the best interest conduct rule? Based on my previous question on timing, this might be an effective way to move forward given the urgency of this issue.

Response:

The proposals are separate but are complementary. The market for investment services spans both broker-dealers and investment advisers. Taken together, the proposals provide a coherent path forward, across this market, on issues that the Commission has been actively considering for nearly two decades. Collectively, the proposals are designed to serve Main Street investors by (1) requiring broker-dealers to act in the best interest of their retail customers; (2) reaffirming and in some cases clarifying the fiduciary duty owed by investment advisers to their clients; and (3) requiring both broker-dealers and investment advisers to clarify for all retail investors the type of investment professional they are and disclose key facts about their relationship. Because these proposals work well together to better clarify and align the standards of conduct for broker-dealers and investment advisers with what investors would reasonably expect, I anticipate staff will recommend adopting these three proposals together.